Deutsche Telekom AG (DTEGY)

Updated November 23rd, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$18	**5 Year CAGR Estimate:**	7.3%	**Market Cap:**	$85.0 B
Fair Value Price:	$17	**5 Year Growth Estimate:**	6.0%	**Ex-Dividend Date:**	6/22/2020[1]
% Fair Value:	109%	**5 Year Valuation Multiple Estimate:**	-1.7%	**Dividend Payment Date:**	6/30/2020
Dividend Yield:	3.8%	**5 Year Price Target**	$22	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	N/A

Overview & Current Events

Deutsche Telekom is the largest telecommunications company in Europe and the second-largest telecommunications company in the world. The company operates through the following segments: Germany, United States, Europe, and System Solutions. The German segment provides fixed-network and mobile solutions as well as wholesale telecommunications services. The United States segment includes T-Mobile (Deutsche Telekom owns ~44% of T-Mobile), while Europe encompasses all fixed-network and mobile operations outside Germany. The Systems Solution segment provides information and communication technology systems. Deutsche Telekom has about 238 million mobile customers, 27 million fixed-network lines, and more than 21 million broadband lines. United States investors can initiate an ownership stake in Deutsche Telekom through American Depository Receipts that trade under the ticker DTEGY with a market capitalization of US$85 billion.

On April 1st, 2020, T-Mobile and Sprint merged in an all-stock deal so now Deutsche Telekom and Softbank own 44% and 24% of T-Mobile, respectively. The new company has increased network coverage and has about 125 million customers, much closer to the 150 and 141 million customers of Verizon and AT&T, respectively, than before the merger.

In mid-November, Deutsche Telekom reported (11/12/20) financial results for the third quarter of fiscal 2020. In the first nine months of the year, net revenue grew 24% thanks to the acquisition of Sprint. Excluding the acquisition, revenue rose 1.9% and adjusted earnings-per-share edged up 4%, from €0.83 to €0.86. Deutsche Telekom is facing a headwind due to the global recession that has been caused by the coronavirus. Due to the pandemic, most stores of the company were shut down for a considerable period in the second quarter. However, telecommunications companies are largely immune to social distancing. It is remarkable that management raised its guidance for annual free cash flow from at least €5.5 billion to at least €6.0 billion ($1.49 per share) thanks to positive business trends both in the U.S and outside the U.S. Moreover, the earnings-per-share are on track to remain approximately flat this year.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.91	$0.92	$0.66	$0.63	$0.79	$0.77	$0.61	$0.89	$1.13	$1.14	***$1.10***	***$1.47***
DPS	$1.03	$0.99	$0.88	$0.93	$0.68	$0.56	$0.63	$0.65	$0.77	$0.78	***$0.68***	***$0.71***
Shares[2]	4,321	4,321	4,321	4,452	4,476	4,587	4,677	4,762	4,761	4,743	***4,743***	***4,700***

Deutsche Telekom's earnings growth has been somewhat volatile, partly due to the spinoff of T-Mobile in 2012. Even including the impact of this spinoff, the company has grown its earnings-per-share by 5.9% per year over the last decade. We believe that this level of growth could continue for the foreseeable future, mostly thanks to continuous growth of T-Mobile. We continue to expect a 6% annual earnings-per-share growth rate beyond this year for this resilient telecommunications giant.

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[1] Annual dividend already paid.
[2] In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.4	14.9	17.2	20.4	20.3	23.1	27.7	20.2	14.6	14.7	***16.4***	***15.0***
Avg. Yld.	7.9%	7.2%	7.7%	7.2%	4.2%	3.2%	3.7%	3.6%	4.7%	4.6%	***3.8%***	***3.2%***

Deutsche Telekom's price-to-earnings ratio has been volatile over the last decade, ranging from as high as 27.7 to as low as 14, with an average value of 18.7. We believe this historical valuation multiple is far too rich for a company like Deutsche Telekom. Given comparable valuations in the domestic telecommunications industry, our target for Deutsche Telekom's fair value is a price-to-earnings ratio of 15. The stock is now trading at an earnings multiple of 16.4. If the stock reaches our fair value estimate over the next five years, it will incur a -1.7% annualized drag in its returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

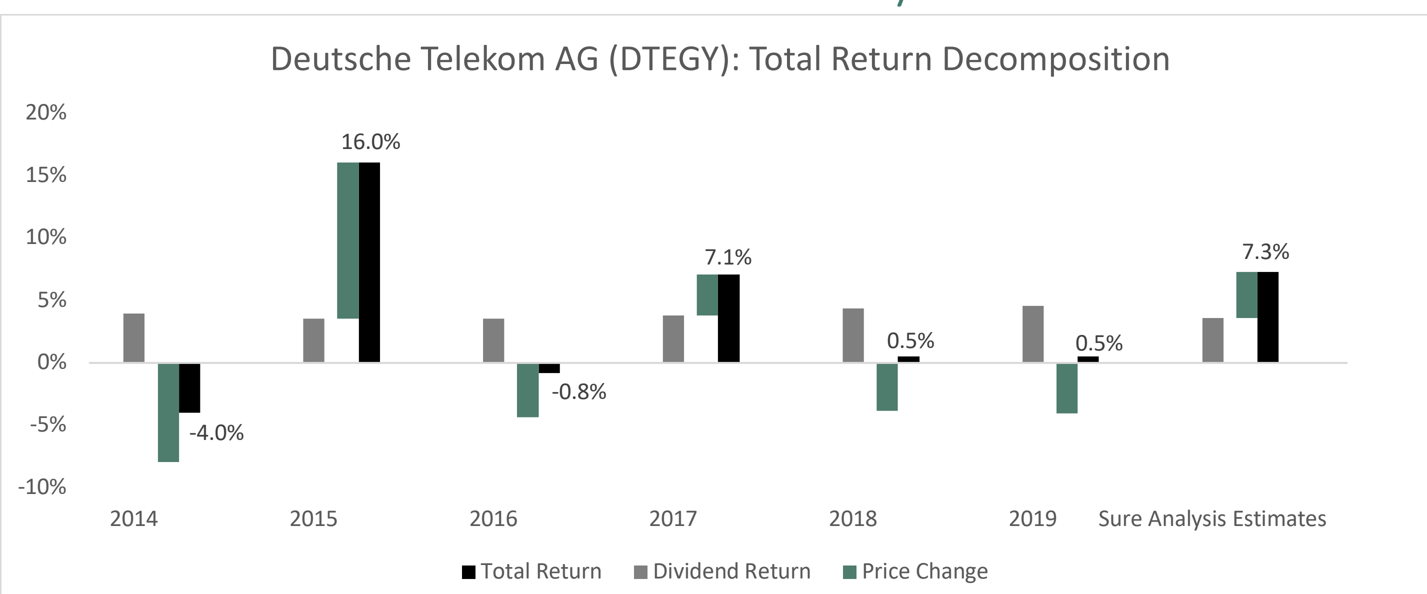
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	113%	108%	133%	148%	86.1%	72.7%	103%	73.0%	68.1%	68.2%	***61.8%***	***48.6%***

Deutsche Telekom has undisputed leadership within the European telecommunications market and is investing aggressively to maintain this position. Last year, the company invested €14.4 billion (US$15.8 billion) to build out its telecommunications network. Deutsche Telekom also has an investment-grade BBB+ credit rating from Standard & Poor's, which allows it to raise capital at attractive rates to continue investing in its future as a business.

Final Thoughts & Recommendation

Deutsche Telekom provides exactly what most investors in the telecommunications sector are looking for: stability, cash flow, and a high dividend payout. Moreover, the company's global business model combined with its ~44% ownership of T-Mobile gives it exposure to telecommunications markets worldwide. In addition, the stock has been trading in a narrow range, between $14 and $20, most of the time in the last seven years. Most returns thus usually come from its generous dividend. This feature also makes it easier to hold the stock for the long term, without emotional pressure to sell during market sell-offs. Deutsche Telekom has rallied 18% in less than a month. Total return potential comes in at 7.3% annually over the next five years. We thus rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	82739	81781	74784	79861	83325	76822	80899	84878	88975	89,767
Gross Profit	35386	34447	30743	31711	43290	39452	42180	44280	46772	51,133
Gross Margin	42.8%	42.1%	41.1%	39.7%	52.0%	51.4%	52.1%	52.2%	52.6%	57.0%
SG&A Exp.	26340	26883	24337	24324	314	353	336	399	509	477
D&A Exp.	15652	20128	28229	14481	14062	12606	14809	16519	16338	19,774
Operating Profit	8658	12493	7129	7538	6045	6591	7225	8204	9059	10,925
Op. Margin	10.5%	15.3%	9.5%	9.4%	7.3%	8.6%	8.9%	9.7%	10.2%	12.2%
Net Profit	2247	750	-6882	1235	3888	3611	2961	3920	2558	4,329
Net Margin	2.7%	0.9%	-9.2%	1.5%	4.7%	4.7%	3.7%	4.6%	2.9%	4.8%
Free Cash Flow	6468	10887	6615	2588	2060	426	2095	-2603	6443	9759

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	170	159	143	163	157	157	157	170	166	191
Cash & Equivalents	3735	4856	5324	11006	9148	7540	8190	3973	4208	6,041
Acc. Receivable	9162	8493	8353	10467	12479	9573	9704	11461	11425	12,149
Inventories	1742	1404	1463	1466	1828	2019	1722	2381	2048	1,756
Goodwill & Int.	71561	65059	55343	63474	62704	62345	64063	75419	74296	76,400
Total Liab. ($B)	113	107	102	119	116	116	116	119	117	139
Accounts Payable	8977	8337	8484	9985	11711	12067	10982	13118	12239	10541
Long-Term Debt	67224	62586	55433	67069	64049	63080	61847	64721	67178	72480
Total Equity	50560	45856	34290	32974	30932	32143	30980	36872	35355	35517
D/E Ratio	1.33	1.36	1.62	2.03	2.07	1.96	2.00	1.76	1.90	2.04

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	1.3%	0.5%	-4.6%	0.8%	2.4%	2.3%	1.9%	2.4%	1.5%	2.4%
Return on Equity	4.4%	1.6%	-17.2%	3.7%	12.2%	11.4%	9.4%	11.6%	7.1%	12.2%
ROIC	2.4%	0.6%	-6.5%	1.2%	3.6%	3.4%	2.9%	3.6%	2.2%	3.6%
Shares Out.	4,321	4,321	4,321	4,452	4,476	4,587	4,677	4,762	4,761	4,743
Revenue/Share	19.09	19.02	17.39	18.27	18.62	16.87	17.49	18.05	18.76	18.93
FCF/Share	1.49	2.53	1.54	0.59	0.46	0.09	0.45	-0.55	1.36	2.06

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.