



Lumen Technologies (LUMN)

Updated February 15th, 2021 by Quinn Mohammed

Key Metrics

Current Price:	\$12	5 Year CAGR Estimate:	11.2%	Market Cap:	\$12.9B
Fair Value Price:	\$14	5 Year Growth Estimate:	1.3%	Ex-Dividend Date¹:	03/06/2021
% Fair Value:	84%	5 Year Valuation Multiple Estimate:	3.7%	Payment Date²:	03/30/2021
Dividend Yield:	8.5%	5 Year Price Target	\$15	Last Dividend Increase:	0
Dividend Risk Score:	D	Retirement Suitability Score:	B	Years of Dividend Growth:	0

Overview & Current Events

Lumen Technologies traces its roots to 1930 when the Oak Ridge Telephone Company was purchased by the Williams family. They would eventually expand exponentially into what has become Lumen, which serves customers in 60 different countries today. It has an \$12.9 billion market capitalization and produced \$20.7 billion in revenue in 2019. The name Lumen was brought about in September 2020 to rebrand and reposition the company as a critical partner in leading enterprises through the 4th Industrial Revolution – or the smart technology revolution. Lumen will help customers deliver things such as smart cities, retail and industrial robots, real-time virtual collaboration, and automated factories.

Lumen Technologies reported fourth quarter results on February 10th. Total revenues for the quarter were \$5.13 billion, down 3.2% from \$5.3 billion from the prior year period. Adjusted earnings per share for the fourth quarter was \$0.48, up 29% year-over-year from \$0.33. The company's net debt has been reduced by roughly \$1.6 billion for the full year 2020. The company's leverage has dropped to 3.6x net-debt-to-adjusted EBITDA. Long-term debt of \$29 billion remains outstanding.

Total broadband subscribers fell from one year ago to 4,544 today. Despite this, and for many quarters in a row, broadband revenue was the only consumer metric which did not decrease YoY, with revenue increasing 1.8%. This is due to the loss of subscribers in broadband being at the lower tier of offerings, while the higher tiers are increasing.

The company has achieved some adjusted EBITDA margin expansion, as it stands at 44.5% vs 42.9% last year. They also achieved \$830 million of annualized run-rate adjusted EBITDA cost transformation savings against the three-year goal of \$800 million to \$1 billion. The company has provided a 2021 outlook, where adjusted EBITDA is seen coming in lower than in 2020, at around \$8.5 billion. Free cash flow of roughly \$2.9 billion is expected in 2021, slightly lower than in 2020. Dividends are expected to cost \$1.1 billion.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$1.07	\$1.25	\$1.64	\$2.61	\$2.72	\$2.45	\$1.58	\$1.19	\$1.32	\$1.67	\$1.57	\$1.67
DPS	\$2.90	\$2.90	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$2.16	\$1.00	\$1.00	\$1.00	\$1.00
Shares³	619	626	584	569	544	547	1,069	1,067	1,078	1,080	1,100	1,100

Lumen has struggled in recent years with competition as well as profitability. The Level 3 acquisition has seen the company's share count double in the past couple of years. In addition, it took on another \$13 billion in debt with the transaction onto a balance sheet that was already in poor shape.

That said, we see 1.3% annual growth going forward as it has some catalysts for earnings expansion. Revenue should continue to move higher from the Level 3 merger. The company is also investing to expand network footprint and enhance the product portfolio. The company has achieved roughly \$830 million of annualized run-rate adjusted EBITDA

¹ Estimate

² Estimate

³ In millions

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cost transformation savings towards the three-year goal of \$800 million to \$1 billion. Reduced leverage should help improve margins over time as well as less of the company's earnings will be consumed by interest expense.

Following the dividend cut in early 2019, we do not believe management will raise the payout anytime soon given the aggressive leverage target of around 3.0 times EBITDA.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	36.2	31.4	21.3	14	11.6	11.4	13.9	13.3	10.8	8.8	7.5	9.0
Avg. Yld.	7.5%	7.4%	6.2%	5.9%	6.9%	7.7%	9.8%	11.4%	13.0%	9.5%	8.5%	6.6%

Lumen's volatile price-to-earnings ratio stands at 7.5 now as earnings remain below record levels. We estimate fair value at 9 times earnings given the marked weakness in the company's recent results, representing a 3.7% annual growth due to valuation multiple expansion. We see the yield falling as a result of a higher share price and flat payout, but it will still be strong, at 6.6%. The recent rebranding of the company as a "technology" company may push the estimated PE slightly higher in the near term, but we would like to see real growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	271%	232%	132%	83%	79%	88%	137%	182%	76%	60%	64%	60%

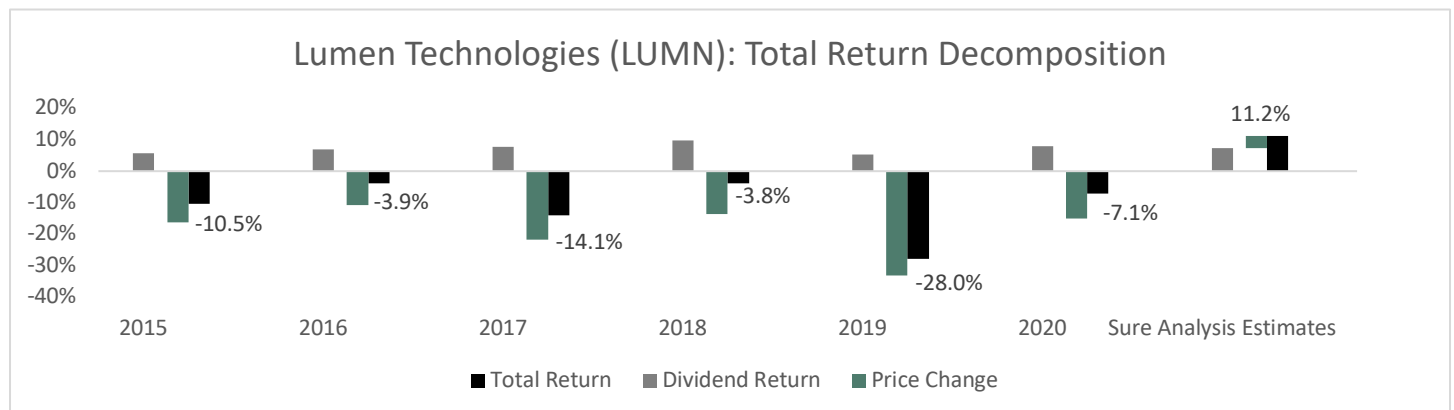
Lumen's payout ratio is now back under 100% after the dividend cut, and we expect the dividend will remain at \$1 per share for the foreseeable future. Management has made it clear the priority is reducing leverage, so we see the payout ratio drifting lower over time as earnings grow but the dividend remains steady.

Lumen's competitive advantage is in its diversified model as well as its tremendous size and geographic reach. It can negotiate in ways smaller competitors cannot and its global footprint provides valuable diversification. While the COVID-19 pandemic overhangs the economy, CTL has a large and diversified customer base with only a small amount of total revenue coming from highly impacted customers (retail, restaurants, hotels, etc.).

Final Thoughts & Recommendation

Lumen Technologies is a stock that offers growth potential and a large yield. We see total returns of 11.2% going forward, most of which comes from the dividend. Thus, it is a buy for aggressive investors, but we caution conservative dividend growth investors that it remains a high-risk, high-reward situation, particularly considering the recent dividend cut and declining revenue.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	15351	18376	18095	18031	17900	17470	17656	23443	22401	20712
Gross Profit	9026	10737	10588	10185	10122	9696	9453	12581	12324	11778
Gross Margin	58.8%	58.4%	58.5%	56.5%	56.5%	55.5%	53.5%	53.7%	55.0%	56.9%
SG&A Exp.	2975	3244	3502	3347	3354	3447	3508	4165	3715	3464
D&A Exp.	4026	4780	4541	4428	4189	3916	3936	5120	4829	4710
Operating Profit	2025	2713	2545	2410	2579	2333	2009	3296	3780	3604
Operating Margin	13.2%	14.8%	14.1%	13.4%	14.4%	13.4%	11.4%	14.1%	16.9%	17.4%
Net Profit	573	777	-239	772	878	626	1389	-1733	-5269	-1232
Net Margin	3.7%	4.2%	-1.3%	4.3%	4.9%	3.6%	7.9%	-7.4%	-23.5%	-5.9%
Free Cash Flow	1790	3146	2511	2141	2281	1627	772	3857	3052	2795
Income Tax	375	473	463	338	438	394	-849	170	503	450

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	56044	53940	51787	49103	47604	47017	75611	70256	64742	59394
Cash & Equivalents	128	211	168	128	126	222	551	488	1690	406
Accounts Receivable	1768	1782	1862	1821	1789	1882	2245	2094		1962
Inventories	107	125	167	132	144	134	128	120		
Goodwill & Int. Ass.	32214	30597	28411	27295	26225	23978	43248	38810	21534	27089
Total Liabilities	35217	34651	34596	34080	33544	33618	52120	50428	51272	48232
Accounts Payable	1400	1207	1111	1226	968	1179	1555	1933		1134
Long-Term Debt	21836	20605	20966	20503	20225	19688	37726	36061	34694	31837
Shareholder's Equity	20827	19289	17191	15023	14060	13399	23491	19828	13470	11162
D/E Ratio	1.05	1.07	1.22	1.36	1.44	1.47	1.61	1.82	2.58	2.85

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	1.5%	1.4%	-0.5%	1.5%	1.8%	1.3%	2.3%	-2.4%	-7.8%	-2.0%
Return on Equity	3.8%	3.9%	-1.3%	4.8%	6.0%	4.6%	7.5%	-8.0%	-31.6%	-10.0%
ROIC	1.9%	1.9%	-0.6%	2.1%	2.5%	1.9%	2.9%	-3.0%	-10.1%	-2.7%
Shares Out.	619	626	584	569	544	547	1,069	1,067	1,078	1,080
Revenue/Share	28.74	29.53	30.11	31.65	32.25	32.31	28.08	21.99	20.91	19.19
FCF/Share	3.35	5.06	4.18	3.76	4.11	3.01	1.23	3.62	2.85	2.59

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