



Telephone & Data Systems (TDS)

Updated February 19th, 2021 by Quinn Mohammed

Key Metrics

Current Price:	\$20	5 Year CAGR Estimate:	12.7%	Market Cap:	\$2.2B
Fair Value Price:	\$30	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	03/15/2020
% Fair Value:	66%	5 Year Valuation Multiple Estimate:	8.6%	Payment Date:	03/31/2020
Dividend Yield:	3.6%	5 Year Price Target	\$32	Years of Dividend Growth:	45
Dividend Risk Score:	B	Retirement Suitability Score:	A	Last Dividend Increase:	3%

Overview & Current Events

Telephone & Data Systems is a telecommunications company that provides customers with cellular and landline services, wireless products, cable, broadband, and voice services across 24 U.S. states. The company's Cellular Division accounts for more than 75% of total operating revenue. TDS started in 1969 as a collection of 10 rural telephone companies. Today the company has a market cap of \$2.2 billion and more than \$5.2 billion in annual revenues.

On February 18th, TDS reported financial results for the fourth quarter. The company grew its total operating revenues by 3% to \$1.38 billion. Diluted earnings were \$14 million for the company, up 17% from last year's \$12 million. Diluted earnings per share grew from \$0.10 to \$0.12, a 20% increase.

Total operating revenues for the full fiscal 2020 year grew 1% to \$5.23 billion compared to \$5.18 billion last year. Diluted earnings per share significantly grew year-over-year, from \$1.03 in 2019 to \$1.93 in 2020, for an 87% gain.

Postpaid churn rate was identical YoY at 1.21%. ARPU for postpaid connections grew from \$47.23 to \$47.51, a 0.6% increase. Total residential revenue per wireline connection grew from \$50.12 to \$51.33 YoY. Total wireline connections grew 1% and cable connections grew 1.8%, bolstered by the acquisition of Continuum. Revenues in the cable segment increased 18%.

Management provided 2021 guidance and expect service revenues at U.S. Cellular of around \$3.1 billion, in-line with 2020 results. Total expected operating revenues for TDS Telecom is around \$1 billion, also in-line with actual 2020 results.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$1.83	\$0.75	\$1.29	(\$1.26)	\$1.98	\$0.39	\$1.37	\$1.17	\$1.03	\$1.93	\$1.90	\$2.00
BPS¹	\$33.60	\$37.16	\$37.85	\$36.39	\$37.86	\$37.67	\$38.45	\$40.00	\$40.46	\$42.02	\$42.50	\$45.78
DPS	\$0.48	\$0.48	\$0.52	\$0.52	\$0.56	\$0.60	\$0.60	\$0.64	\$0.66	\$0.68	\$0.70	\$0.81
Shares²	118.0	108.0	109.0	108.0	109.0	110.0	112.0	115.0	116.0	116.0	115.0	125.0

TDS has an 82% stake in U.S. Cellular and essentially relies on this stake to achieve growth, as its other businesses, namely residential wireline, broadband and voice connections, have failed to grow in recent years. In 2021, U.S. Cellular is focusing on connecting customers in underserved areas with their high-quality network, as well as market share expansion, increasing business with government customers in 5G and IoT, and improving network modernization and 5G programs.

The company has exhibited a markedly volatile performance record. During the last decade, its earnings-per-share have increased approximately 0.6% compounded per year on average. While the earnings trend has been volatile, book value per share has grown by 2.5% per year over the last decade. The book value trend is much more consistent. As TDS

¹ Book-value-per-share

² In millions

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distributes roughly half of its earnings in dividends, we are projecting a book value per share around \$45.78 by 2025 for a 1.5% average annual growth of book value over the next five years.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/B	0.87	0.64	0.67	0.7	0.74	0.73	0.75	0.73	0.7	0.5	0.5	0.7
Avg. Yld.	1.6%	2.1%	2.0%	2.1%	2.1%	2.1%	2.2%	2.2%	2.3%	3.4%	3.6%	2.5%

Due to the volatility in the company's earnings, we believe that the best way to assess the valuation of TDS is by looking at its price-to-book ratio. TDS is currently trading at a price-to-book ratio of 0.50, which is lower than its 10-year average of 0.70. If the stock reverts to its average valuation level over the next five years, it will enjoy an 8.6% annualized gain.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	26%	64%	40%	-41%	28%	154%	44%	55%	64%	35%	37%	41%

TDS has raised its dividend for 45 consecutive years. It has grown its dividend by 3% per year on average over the past 5 years. Today, its 3.6% dividend yield is above the yield of the S&P. Moreover, the company has exhibited serious volatility in its results. This is a negative that investors should not underestimate. When a stock has such unpredictable performance, it should be viewed as speculative. A consistent growth record is an important attributes of a stock, and TDS does not possess this. As TDS operates in a highly competitive business, it lacks a meaningful competitive advantage.

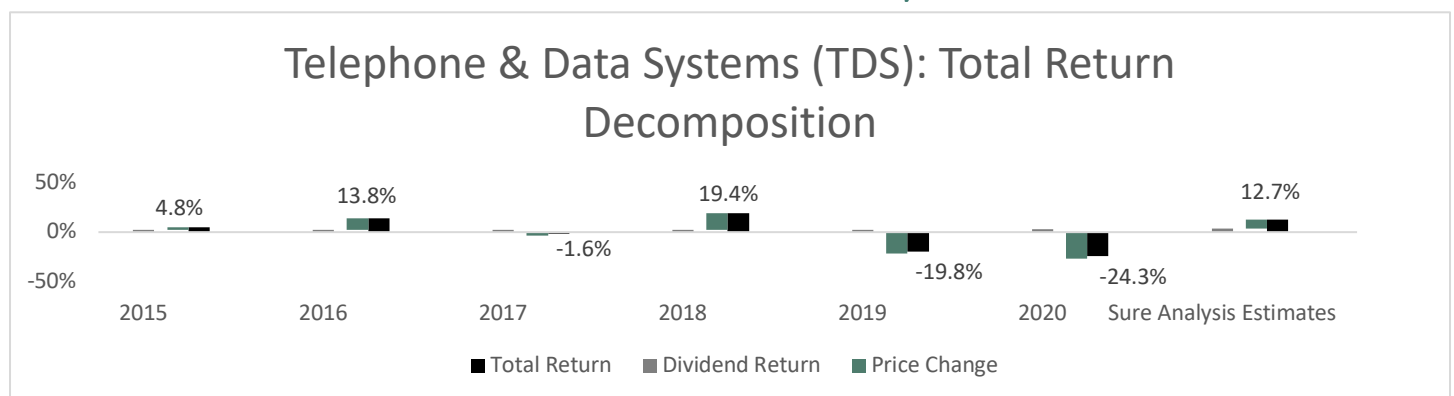
Another risk factor of TDS is its strong dependence on U.S. Cellular, which operates in an extremely competitive market. As U.S. Cellular generates the vast majority of the revenues and earnings of TDS and is currently its most important growth driver, any headwind that may show up in the way of U.S. Cellular will have a severe impact on TDS.

TDS Telecom is lucky in that its services are heavily in-demand throughout the coronavirus pandemic which has led us into the latest recession.

Final Thoughts & Recommendation

TDS relies heavily on the performance of U.S. Cellular, however management is not forecasting exceptional growth currently. We forecast the stock will offer a 12.7% average annual return over the next five years. We have been somewhat conservative in our growth forecast due to the extremely volatile performance record, which makes for a risky holding. Growth is expected to be slow and the bulk of the return would be due to valuation expansion. We rate TDS a buy but believe there are better growth opportunities in the telecom space.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	5180	5345	4901	5009	5210	5155	5044	5109	5176	5225
Gross Profit	3130	3073	2676	2498	2795	2726	2685	2773	2839	2871
Gross Margin	60.4%	57.5%	54.6%	49.9%	53.6%	52.9%	53.2%	54.3%	54.8%	54.9%
SG&A Exp.	2002	2034	1948	1865	1781	1762	1689	1694	1717	1681
D&A Exp.	766	814	1018	837	844	850	844	883	932	909
Operating Profit	362	225	-290	-204	170	114	152	196	190	281
Operating Margin	7.0%	4.2%	-5.9%	-4.1%	3.3%	2.2%	3.0%	3.8%	3.7%	5.4%
Net Profit	201	82	142	-136	219	43	153	135	121	226
Net Margin	3.9%	1.5%	2.9%	-2.7%	4.2%	0.8%	3.0%	2.6%	2.3%	4.3%
Free Cash Flow	284	110	-389	-404	-11	146	91	241	59	164
Income Tax	114	74	126	-5	172	40	-279	46	64	19

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	8201	8624	8904	8854	9422	9446	9295	9783	10781	12525
Cash & Equivalents	563	740	830	472	985	900	619	921	465	1429
Accounts Receivable	394	410	552	549	705	753	861	992	1005	1004
Inventories	130	161	245	274	158	151	145	150	169	154
Goodwill & Int. Ass.	2342	2336	2456	2534	2901	2938	3020	2957	3266	3398
Total Liabilities	3598	3968	4234	4399	4718	4696	4403	4490	5377	6932
Accounts Payable	365	377	496	387	349	365	368	365	374	508
Long-Term Debt	1531	1723	1722	1942	2454	2445	2457	2439	2326	3429
Shareholder's Equity	3962	4012	4118	3926	4126	4144	4269	4560	4653	4804
D/E Ratio	0.39	0.43	0.42	0.49	0.59	0.59	0.58	0.53	0.50	0.71

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	2.5%	1.0%	1.6%	-1.5%	2.4%	0.5%	1.6%	1.4%	1.2%	1.9%
Return on Equity	5.2%	2.1%	3.5%	-3.4%	5.4%	1.0%	3.6%	3.1%	2.6%	4.8%
ROIC	3.3%	1.3%	2.2%	-2.1%	3.2%	0.6%	2.1%	1.8%	1.6%	2.7%
Shares Out.	118.0	108.0	109.0	108.0	109.0	110.0	112.0	115.0	116.0	116.0
Revenue/Share	47.48	49.07	44.91	46.38	47.36	46.44	45.04	44.82	44.62	45.43
FCF/Share	2.60	1.01	-3.57	-3.74	-0.10	1.32	0.81	2.11	0.51	1.43

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

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