Telus Corporation: Can the High Dividend Growth Be Sustained?

Description

Telus Corporation (TSX: T)(NYSE: TU) announced solid third-quarter results, but the cash flow was negatively impacted by higher finance and tax charges and increased capital expenditures. The dividend was increased by 11%, and a considerable number of shares have been repurchased from the market.

Telus management has also committed to continue the dividend growth rate of 10% per year until 2016 and to continue with the share repurchase program. The question is whether this rate of capital return to shareholders is sustainable.

Solid third-quarter results

Profit for the third quarter amounted to $387 million, which on an adjusted basis was 6% higher than the year before. Revenue increased by 5.4%, and with operating expenses 6% higher, operating income increased by 2.7%. As a result of considerable share repurchases, earnings per share rose by 10% to $0.64. The overall result was better than expected.

Telus is forecasting profit-per-share growth of between 11%-20% for the full year, and indications are that this target will be reached.

Sound all-around operational performance

In the wireless segment, the operating metrics all moved in the right direction during the quarter, with the number of subscribers increasing by 2.3%, average revenue per user by 3.2%, and user churn down slightly. Data network revenue increased by 24% during the quarter, reflecting higher data usage from continued adoption of smartphones and other data-centric wireless devices.

Equally positive from the business profitability perspective was the 3.8% increase in the number of post-paid users, which carry considerably higher average revenues than prepaid users. Adjusted EBITDA in this division increased by 5% to $718 million, although margins were slightly lower compared to the previous year.

The wireline division fared equally well, with strong year-over-year subscribers increases recorded in the high-speed Internet (+5.7%) and TV categories (+14.4%). The secular decline in local and international fixed phone lines continued, although the rate of decline moderated somewhat. Adjusted EBITDA increased by 3.3% to $377 million during the quarter, while margins moved marginally higher.

Reduced cash-flow generation and higher debt

As a result of higher income taxes and interest payments, operating cash flow was somewhat lower during the first nine months of the year but still represented a high cash conversion rate of 28% of revenue. As a result of considerably higher capital expenditures, free cash flow declined by 21% to $720 million in the first three quarters of the year.

Telus is a prolific cash generator, and the current year decline in free cash flow should be reversed as considerable investments in broadband infrastructure (to support the rollout of the newly acquired 700 MHz spectrum and fibre-optic cable connections) start to enhance profits.

Telus increased its dividend payment for the fourth quarter by 11%, to $0.40, and also completed the acquisition of 2.1% of the outstanding shares valued at $500 over the past year. Approval has been obtained for the purchase of another 2.6% of the outstanding shares over the next year.

Free cash flow is still covering the dividend payments so far this year. But the substantial share repurchases, combined with a $1.1 billion cash payment for the additional 700 MHz spectrum, resulted in an increase of the net debt to $9.3 billion. The debt-to-capital ratio is now fairly high at 53% compared to 50% last year.

High-quality business with an attractive dividend payment profile

The positive investment case for Telus is based on the sound historical track record, competitive market position, strong cash-flow generation and considerable distributions to investors through dividends and share repurchases.

The company is committed to grow the dividend at a rate of 10% per year until 2016 and to continue the share repurchase program. Given the outstanding track record and the sound operating and financial performance, there is no reason to suspect that this will not be sustainable.

The valuation of the company is reasonable, with an EV/EBITDA valuation of around 7.7 times, a price-to-earnings ratio of 15.9, and a dividend yield of 3.9% for the next 12 months. This valuation is at a slight premium to its Canadian peers but probably well-deserved given the quality of the business.

CATEGORY

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Date
2025/08/20
Date Created
2014/11/10
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