Telus Corporation: Still a Core Holding?

Description

In the beginning of January, I wrote an article about **Telus Corporation** (TSX:T)(NYSE:TU) asking whether or not it was a core holding. And while there were many great things about the company, two things concerned me: the debt and, more importantly, the fall in free cash flow. I said, "That sort of drop happens from time to time, but it could be concerning if it happens repeatedly."

Well, it happened again.

In Q4, free cash flow decreased by $388 million year over year. Whereas in 2015, it generated $197 million in free cash flow, in Q4 2016, it lost $191 million in free cash flow. This concerns me quite a bit because free cash flow is what funds the dividend. If there is no cash, there's no dividend. And if we look at 2016 as a whole compared to 2015, Telus went from generating $1.078 billion in free cash flow to only $141 million.

According to management, "the decrease was mainly due to the $391 million increase in capital expenditures," along with an increase in taxes and interest payments. No matter the cause, going from over $1 billion in generated free cash flow to only $141 million in a full year is concerning, increasing my nervousness about the long-term prospects.

But this is only one number. There are other things worth considering.

First, it had 127,000 net new postpaid internet, TELUS TV, and wireless customers, which is up 17% from 2015. Not only is it getting new customers, but it is also limiting how many customers it loses with a monthly postpaid churn of 0.98%. This means that it loses less than 1% of its customers each month, which is significant in comparison to other companies. This is the third consecutive year that churn has stayed below 1% — a testament to the company's strong customer service.

Second, Telus increased its average revenue per user by 3.9% in the fourth quarter. Compared to its competitors, Telus ranks as the best with $5,300 in lifetime revenue per client. This becomes a compounding effect because it loses fewer customers, allowing it to generate even more from them as the years go on. Further, because Telus doesn't lose as many customers as others, it doesn't need to spend as much in sales and marketing.

And finally, there's the fact that Telus returns quite a bit of money to its investors. According to Darren Entwistle, CEO, "we returned over $1.2 billion to shareholders in both dividends and share purchases" in 2016. He went on to explain that since 2004, "Telus has now returned approximately $14 billion to shareholders, including $8.7 billion in dividends and $5.2 billion in share purchases." And going forward, management expects to see the dividend increase by 7-10% in 2017.

So there are obviously great things about Telus. Nevertheless, that cash flow problem is hanging over its head, and it's something that needs to be corrected. Am I buyer right now? No. But that doesn't mean I'd be a seller either. The company will continue to find ways to pay its dividend, so that should leave investors feeling somewhat relieved. However, with this announcement that its cash flow dropped so much, Telus can no longer be a core holding for me.

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