Telus Corporation: An Income Investor’s Favourite With 1 Major Risk

Description

Telus Corporation (TSX:T)(NYSE:TU) is one of those companies that investors love to buy and hold primarily because it pays a very lucrative dividend. Telus is one of those “sleep well at night” (SWAN) stocks; essentially, it generates income for your portfolio without you really needing to check in on it.

While I think SWAN stocks are great, I am no longer sleeping well at night when it comes to Telus because the company’s cash flow situation is not strong enough to support the dividend that it pays. In 2015, it generated $1.078 billion in cash flow, which was a strong year. But in 2016, it only earned $141 million in cash flow.

Things get worse when we look at the fourth quarter specifically. It actually lost $191 million in cash flow in Q4 2016 versus the $197 million it earned in Q4 2015. But in that same quarter, it paid out $272 million and spend $39 million of Telus shares. So, you’ve got a company that is paying out far more than it is bringing in. A small corporation can’t pay a dividend in an amount greater than the amount of cash flow brought in.

Yet Telus continues to try to be an income investors’ favourite, which requires it to find cash in other ways — with debt.

Over the past five years, the company’s debt-to-equity ratio has increased from 0.875 to 1.646. It continues to borrow money for a multitude of projects, but it always has just a little extra for “general corporate purposes.” Those purposes can include paying a dividend. Said another way, the company is borrowing money (and paying interest), so it can pay dividends to its investors.

But this doesn’t immediately mean that Telus is a dangerous stock. Only $3 billion is due before July 2020. Billions of dollars of its debt are not due until the mid-2020s, and quite a bit is not due until the 2040s. Nevertheless, the interest that it has to pay on this debt will become a bigger problem as time goes on. And if interest rates rise, this can become an even bigger problem.

Here’s the thing, though: having weak cash flow quarters or even years is not the be-all, end-all. It happens to most companies. And Telus is still an incredible business with 13 million customers and some of the best customer service on the planet. With a churn rate below 1% quarter after quarter, the company is in a great place to continue growing.

But Telus is an important example for active investors to never truly stop analyzing their companies. With a company that is taking on growing amounts of debt while still promising to grow the dividend by 7-10% per year, it’s important to pause and consider if the investment really is safe.

I believe Telus is a great company, but the company is not an immediate buy for me because of its debt problems. If I see cash flow increasing again, my opinion will change.

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