Telus Corporation: Trouble in Paradise?

Description

Quarterly results can be great or terrible if you're actively looking at your stocks. I've seen stocks in my portfolio increase by 10% in one day thanks to a great quarter. I've also seen the opposite.

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Telus Corporation (TSX:T)(NYSE:TU), one of the major telecommunications companies in Canada, released its earnings earlier in the month. Although they weren't bad, they left some investors worried.

Let's dive into the numbers, and then we can look at what I view to be the trouble in paradise for Telus.

Telus's operating revenues were strong at $3.27 billion, up 3.9%. And even its adjusted EBITDA was up 3.6% to $1.23 billion. But, as dynamic duo, Warren Buffett and Charlie Munger, would say, EBITDA is "horror squared."

EBITDA stands for earnings before interest, taxes, depreciation, and amortization. Essentially, it is your earnings before indirect costs. If we looked just at EBITDA, the company is doing fine.

The problem is, EBITDA doesn't take into consideration huge potential expenses. For Telus, it's financing charges — a.k.a. interest. That's why its adjusted net income was actually down 2.7% to $404 million. This is significant; I've been increasingly concerned about the company's debt, and we're beginning to see that it's having an impact on net income.

The gross interest expense for the quarter was $144 million, up 4.3% from Q2 2016. It's a small increase, but it demonstrates that the average long-term debt balances outstanding for the company is increasing.

We know this is true because in December, Telus had US$613 million in outstanding commercial paper. By March, that had grown to US$1.122 billion. If a company continues to pick up debt, it has to pay more interest, and that cuts into net income.

Part of the reason debt has increased so much is because of the company's desire to consistently increase its dividend. With interest rates so cheap, it was a great way for Telus to reallocate the bulk of its resources to rewarding investors. And the company does a great job at that with a 4.43% yield and a quarterly distribution of $0.49.

The problem is simple: interest rates are beginning to increase.

What really concerns me is that Telus's weighted average interest rate on long-term debt was 4.16% in June 2017 compared to 4.32% in June 2016.

Wait — that's a lower interest rate. That's good, right? It is, except for the fact that despite a lower rate, Telus paid more in interest. If rates begin to increase, this could become a bigger problem.

Telus is an awesome company, and although its net income is struggling in part because of its interest costs, it pays a lucrative dividend.

And, just as importantly, Telus is an integral part of our society, because we're all addicted to our phones.

I'm not suggesting that Telus is going to go bankrupt; it's still profitable and is generating cash flow, which is what's needed to actually make the interest payments.

For years, we've called Telus a buy-and-forget stock. Telus's earnings release is a reminder that there's no such thing as a buy-and-forget stock.

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Management's strategies change, and sometimes they fall out of sync with our original thesis. Don't check your stocks regularly, but every once in a while, reassess your thesis.

Telus is a great company, but its debt is becoming a problem — we see that in the earnings.

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