Want to Soften Your Phone Bill? Buy Telus Corporation

Description

Telus Corporation (TSX:T)(NYSE:TU) announced results for another good year with another positive year predicted by management. With solid growth in key areas of mobile communications and high speed internet and a dividend yield of 3.9%, investment returns should remain attractive.

Solid 2014 results

Profit for the full year amounted to $1.4 billion which, on an adjusted basis, was 10% higher than the year before. Revenue increased by 5.2% and with operating expenses 5% higher, operating income increased by 7.5%. As a result of considerable share repurchases, earnings per share rose by 15% to $2.31 while the dividend was increased by 12% to $1.52 per share. This was a good result.

Telus is forecasting profit per share growth of between 4% and 13% for 2015 while management has previously committed to continue a dividend growth rate of 10% per year until 2016.

Sound all around operational performance

In the wireless segment, the operating metrics all moved in the right direction during the final quarter with the number of subscribers increasing by 3.8%, average revenue per user by 3.8% and user churn slightly down. 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 5.3% increase in the number of post-paid users, which carry considerably higher average revenues than prepaid users. EBITDA in this division increased by 4.7% to $2.7 billion for the full year although margins were slightly lower as a result of the high cost of increasing smartphone sales.

The wireline division was again held back by the ongoing decline in local and international fixed phone lines although high speed internet and TV covered the gaps by increasing subscribers by 5.7% and 12.4% respectively. EBITDA increased by 5.3% to $1.5 billion during the year while margins moved marginally higher.

Stable cash flow generation but higher debt

Telus remains an exceptional generator of cash with operating cash flow 5% higher than the previous year and a high cash conversion rate (that is how much cash is generated from sales) of 28% of revenue.

The company had a heavy year of capital expenditures, including the $1.1 billion acquisition of the 700 MHz spectrum licenses. This resulted in free cash flow (that is operating cash flow minus capital expenditures) being slightly negative for the year.

Telus increased its dividend payment for the year by 12% and also completed the acquisition of 2.6%

of the outstanding shares valued at $615 million over the past year. The total cash returned in this way to investors was $1.5 billion.

As a result of the heavy capital expenditures and shareholder cash returns, net debt increased by $1.8 billion during the year. The debt-to-capital ratio is now fairly high at 56% but interest cost is still comfortably covered by operating profits. Telus will ideally want to reduce the debt load before interest rates start to creep up.

Telus is a prolific cash generator and the current year decline in free cash flow should be reversed as the 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. However, management indicated that the capital expenditures for 2015, excluding spectrum acquisitions, should again be around $2.3 billion. More spectrum license auctions are scheduled for this year, which may result in another year of heavy spending for the company. This remains a concern.

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.

On the negative side, one has to be aware of the limited domestic growth opportunities and the real threat of a government favoured fourth national telecommunications player and the increasing debt load.

The valuation of the company is reasonable with an EV/EBITDA valuation of around 7.8 times, a price/earnings ratio of 16 times and a dividend yield of 3.9% for the next 12 months. This valuation is in line with its main Canadian rival **BCE Inc** but higher than the U.S. peers.

I would argue that this valuation is perfectly reasonable for a high quality business.

CATEGORY

1. Dividend Stocks
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