

# QC INVESTMENT MEMO

**To:** Queen's Capital Executive Board  
**From:** Anish S  
**Date:** 17<sup>th</sup> January 2016  
**Re:** TELUS (TSX:T)

## COMPANY PROFILE

Industry: Telecommunication Services  
 Main Asset(s): Wireless/Wireline

Market Capitalization: 21,806.6 mm  
 Debt: 11,813.0 mm  
 Cash: 156.0 mm  
 Enterprise Value: 33,463.8 mm

NTM(E) Revenue: 12,932.0 mm  
 NTM(E) EBITDA: 4,620.6 mm  
 NTM(E) FCF: 1,295.4 mm

## INVESTMENT PROFILE

Current (Proposed) Investment Size: N/A (hold)  
 Position Cost Basis: N/A (hold)  
 Current Share Price: \$36.35  
 Life to Date Profit (Loss): + \$17.85  
 Life to Date Percentage Return: 96.49%

Base Case Valuation: \$36.84 (1% - one year)  
 Downside Case Valuation: \$36.01 (-1% - one year)  
 Upside Case Valuation: \$39.06 (7% - one year)

## COMPANY DESCRIPTION

TELUS Corp. is a telecom provider that operates in Canada, its two major operating segments are Wireless and Wireline. The company provides services including wireless and wireline voice and data services, cloud based solutions/data hosting, and television. They also provide and operate various technology outsourcing solutions for other companies, additionally they have some operations working in the healthcare sector.

As mentioned before TELUS provides wireless solutions hence they hold spectrum licenses for various wireless services and applications (850, 1900, 700 and 2500 MHz). TELUS has approximately 14 million customer connections, including 8.4 million wireless subscribers, 3.1 million wireline network access lines, 1.5 million high-speed Internet subscribers, and 980,000 TELUS TV customers.

## VALUATION

	Day Close Price Latest	52 Week High Price Latest	52 Week Low Price Latest	Market Capitalization Latest	TEV/EBITDA LTM - Latest	LTM Return on Assets %	P/BV LTM - Latest	NTM Forward P/E (Capital IQ)	LTM Return on Capital %
Shaw Communications, Inc. (TSX:SJR.B)	16.51	20.93	15.98	7,976.0	7.9x	6.5%	2.2x	13.29x	8.4%
BCE Inc. (TSX:BCE)	37.76	41.49	35.53	32,680.3	9.2x	6.6%	3.8x	15.99x	8.5%
Quebecor Inc. (TSX:QBR.B)	23.64	24.3	16.93	2,899.7	8.1x	5.0%	10.8x	15.06x	6.5%
Rogers Communications Inc. (TSX:RCI.B)	33.37	37.6	28.07	17,145.8	8.7x	6.2%	4.3x	16.28x	7.6%
TELUS Corporation (TSX:T)	25.05	31.14	25.02	15,029.9	8.9x	6.5%	2.9x	13.80x	8.7%

Summary Statistics	Day Close Price Latest	52 Week High Price Latest	52 Week Low Price Latest	Market Capitalization Latest	TEV/EBITDA LTM - Latest	LTM Return on Assets %	P/BV LTM - Latest	NTM Forward P/E (Capital IQ)	LTM Return on Capital %
High	37.76	41.49	35.53	32,680.3	9.2x	6.6%	10.8x	16.28x	8.5%
Low	16.51	20.93	15.98	2,899.7	7.9x	5.0%	2.2x	13.29x	6.5%
Mean	27.82	31.08	24.13	15,175.4	8.5x	6.1%	5.3x	15.15x	7.8%
Median	28.51	30.95	22.5	12,560.9	8.4x	6.3%	4.1x	15.53x	8.0%

As seen in the comparable analysis table TELUS trades at a discount when equated to its direct competitor Rogers on various industry multiples. All while having a lower P/E and a higher ROC when compared to Rogers. Additionally, the industry wide impact of the economy can be seen on the 52 week high/low of each of these telecommunication companies.

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EBITDA Multiple Method							
Current Price (CAD)		36.35					
Consensus Price Target		43.33					
DCF Estimated Value per Share (CAD)		39.06					
DCF Estimated Upside		7%					
Terminal EBITDA Multiple							
		3.6x	5.1x	6.6x	8.1x	9.6x	
Discount Rate (WACC)	4.40%	21.5	31.46	41.41	51.37	61.32	
	4.90%	20.78	30.5	40.22	49.94	59.66	
	5.40%	20.08	29.57	<b>39.06</b>	48.55	58.05	
	5.90%	19.4	28.67	37.94	47.21	56.47	
	6.40%	18.73	27.79	36.84	45.89	54.95	
			3.6x	5.1x	6.6x	8.1x	9.6x
		4.40%	-41%	-13%	14%	41%	69%
		4.90%	-43%	-16%	11%	37%	64%
		5.40%	-45%	-19%	<b>7%</b>	34%	60%
		5.90%	-47%	-21%	4%	30%	55%
		6.40%	-48%	-24%	1%	26%	51%

The EBITDA Multiple Method was used to calculate the estimated upside using the guidance provided by TELUS Corp in its last earnings call. Consensus values were considered and used for the WACC.

## INVESTMENT THESIS

Considering an investment window of one year there is limited upside. While Telus Corp. is a very stable and financially sound entity it has limited growth opportunities for the foreseeable future. Therefore, this investment opportunity should be revisited when the Canadian Telecom Industry has recovered from the current downward pressure by the CAD and new entrants into the market.

I would recommend a current investor to hold their position in Telus due to their attractive and consistent dividend yields. As the economic pressure. However, since QC has no holdings in the company a new investment should not be made at this time.

## KEY INVESTMENT RISKS

<b>RISK I</b>	<p>Description of Risk I: Increase in competition from Shaw. As it has been announced Shaw has spun off its media division (Shaw Media) and sold it off to Corus Entertainment Incorporated. As recently as the end of 2015 there were suggestions that Corus may be acquired by Shaw. Therefore, this sale by Shaw indicates that Shaw is now completely focused on becoming the fourth player in the Canadian telecom industry. The sale of its media division signals that Shaw is very confident about the acquisition of WIND being approved by the Canadian regulators.</p> <p><i>Mitigating Factor to Risk I: The Canadian telecom industry is very hard to enter, many new entrants have failed to enter this market due to the large capital required to blanket a country the size of Canada with a wireless network. This was witnessed most recently by the inability of the winners of the 2008 spectrum auction to launch new wireless companies. Even with the various regulatory restrictions on the incumbents in the 2008 spectrum auction, the incumbents were able to acquire most of the new entrants within five-ten years of their launch (WIND - Shaw, Mobilicity – Rogers, Public Mobile – TELUS).</i></p>
<b>RISK II</b>	<p>Description of Risk II: Low subscriber growth prospects. There are additional reasons for a low subscriber growth because of stagnant technological changes in the wireless industry. The last major launch of a new network technology LTE brought along a new wave of subscribers. However, the reasons for upgrading to faster network technologies for consumers currently do not exist because of data caps. The LTE-A launch has not seen the same fan fair that the LTE launch received, and with that being said new reasons for subscriber growth is currently not present.</p> <p><i>Mitigating Factor to Risk II: TELUS and most of the other incumbents mitigate this risk by increasing prices on their plans regularly. The most recent price increase was announced in Jan. 2016 and it increased the BYOD plan prices across all incumbents by \$5-\$10 directly raising ARPU of new subscribers.</i></p>
<b>RISK III</b>	<p>Description of Risk III: Weak CAD causing an increase in smartphone prices. As seen starting in 2014 the most popular phones have all increased their prices in Canada. This in addition with the stoppage of three year contracts has meant very high new two-year contracts. From 2013 to 2016 the price of a standard new smartphone under a contract has increased from \$199.99-\$299.99 – three years to \$349.99-\$499.99 – two years. This has lead most Canadian consumers either holding onto their smartphones for a longer period of time or purchasing older phones on contracts to reduce the large upfront cost. The consumers are also considering mid-ranged smartphones being flooded into the market by Chinese manufacturers such as Huawei and Xiaomi.</p> <p><i>Mitigating Factor to Risk III: Smartphones have a limited lifespan, especially when compared to other high cost consumer purchases (laptops, tablets). This is due to the fast pace that most smartphone companies are currently introducing hardware and software changes. Therefore, the average consumer usually upgrades to a new smart phones every two years and at the latest every three years. However, a lot of customers are being attracted to mid-ranged smartphones.</i></p>

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## KEY INVESTMENT STRENGTHS

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<b>STRENGTH I</b>	Description of Strength I: Telus has consistently hiked its dividends over the past few years. At its currently \$0.44 per share quarterly dividends, Telus provides ~5% yearly returns. They still have room to increase payouts moving forward.
<b>STRENGTH II</b>	Description of Strength II: Strong Spectrum Holdings – Telus has made large investments into its spectrum holdings, most recently they purchased the 2500 Mhz spectrum. The spectrum alone will increase in value as the data requirements for future generations increase.
<b>STRENGTH III</b>	Description of Strength III: Wireless Industry Moat – beyond the introduction of Shaw into the Canadian Telecom Industry there aren't any threats for new companies to enter this market. Due to tough market regulations.
<b>STRENGTH IV</b>	Description of Strength IV: Customer Retention – Telus has consistently had a customer churn rate of less than 1% due to this Telus has a much higher customer retention compared to its competitors.

## INDUSTRY DETAILS

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There are three main incumbent telecom operators in Canada. However, all of them are currently under stress due to the weak CAD (increasing cost of smartphones) causing consumers to shy away from new sign-ups. In addition to low consumer spending during the end of this year, Shaw is now looking to join the incumbents as a fourth national carrier with its pending purchase of WIND. Due to these market stresses the industry is due for a stagnant year when it comes to revenue/subscriber growth. TELUS is a strong stock when it compared to the incumbents, however as an investment it is not due for considerable growth at this time. There is limited room for upside even as the CAD rebounds. Additionally, the new entrants in the market, regulatory changes, increased prices and the sluggish nature of innovation in the telecom sector (no reason for upgrades beyond LTE) may cause decreased subscriber acquisitions. Even with the recently announced increase in prices by all the telecom providers (ROGERS, BELL, TELUS) there are limited options for them all to increase ARPU. Considering the market stresses listed above, the telecom market overall is due for an inert year. However, TELUS is still a solid company with diversified holdings in various sectors, and they have consistently given strong dividend yields.