

Telstra Group (TLS)

Just a few scratches

Recommendation

Buy (unchanged)

Price

\$3.62

Target (12 months)

\$4.20 (previously \$4.25)

Sector

Telecommunication Services

Expected Return

Capital growth	16.0%
Dividend yield	5.0%
Total expected return	21.0%

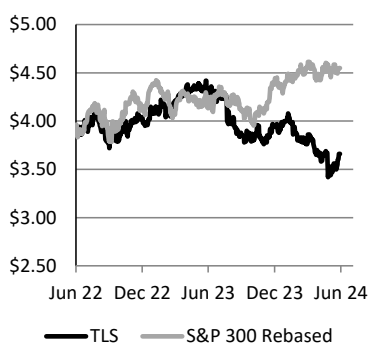
Company Data & Ratios

Enterprise value	\$56,964m
Market cap	\$41,827m
Issued capital	11,554m
Free float	100%
Avg. daily val. (52wk)	\$125.6m
12 month price range	\$3.39 - \$4.42

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.57	3.78	4.42
Absolute (%)	2.52	-3.17	-17.19
Rel market (%)	3.32	-4.26	-23.07

Absolute Price



SOURCE: IRESS

Forecasts updated for restructuring costs

We update our Telstra forecasts for the flagged restructuring costs of \$200-250m across FY24 and FY25 due to the reduction of up to 2,800 staff. We assume the midpoint of the range and apply \$100m in FY24 and \$125m in FY25. Note there is no change in our underlying forecasts and our underlying EBITDA of \$8.2bn and \$8.6bn in FY24 and FY25 remain consistent with the guidance ranges of \$8.2-8.3bn and \$8.4-8.7bn in each period. The restructuring costs only impact our statutory forecasts and the impact is 1% downgrades in EBITDA in FY24 and FY25. Note the restructuring costs are expected to be tax deductible and we have assumed so in our forecasts. The impact on statutory NPAT is downgrades of 3% and 4% in FY24 and FY25.

Investment view: PT down 1% to \$4.20, Maintain BUY

Our overall view of the update last month was slightly net negative given the size of the job cuts suggests the \$500m cost reduction target by FY25 is proving difficult and the turnaround in Enterprise is likely to be slow. But the removal of annual CPI price rises for postpaid mobile price plans we did not view negatively – as it provides flexibility – and in our view does not indicate increased competition in mobile (as supported by the price rises by Optus in late May). We therefore increase the discount we apply in the PE ratio valuation from 5% to 15% and increase the WACC we apply in the DCF from 8.8% to 8.9%. The net result is a 1% decrease in our PT to \$4.20 which is still a 16% premium to the share price so maintain the BUY recommendation.

Looks reasonable value

Telstra is trading on an FY25 PE ratio of 18.6x based on our underlying forecasts which is a 24% discount to the average 24.4x of the peers (ALL, COL, CSL, GMG, WES and WOW). We view some discount as appropriate but in our view this looks excessive, particularly given the forecast mid to high single digit EPS growth over the next few years, strong market position and the potential for some or all of InfraCo to be sold in the medium term. We also believe the forecast yield of c.5% is supportive of the share price which is higher than all of the peers.

Earnings Forecast

Year end 30 June	2023	2024e	2025e	2026e
Total income (A\$m)	23,245	23,687	24,122	24,581
Underlying EBITDA (A\$m)	7,950	8,221	8,599	8,924
Underlying NPAT (A\$m)	2,023	2,093	2,248	2,420
Underlying EPS (diluted) (A¢ps)	17.5	18.1	19.5	20.9
EPS growth (%)	22%	3%	7%	8%
PER (x)	20.7	20.0	18.6	17.3
Price/CF (x)	6.8	6.6	6.1	5.8
EV/Underlying EBITDA (x)	7.2	6.9	6.6	6.4
Dividend (A¢ps)	17.0	18.0	19.0	20.0
Yield (%)	4.7%	5.0%	5.2%	5.5%
ROE (%)	13.3%	14.0%	14.9%	16.4%
Franking (%)	100%	100%	100%	100%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Forecast and Valuation Changes

Forecasts Updated for Restructuring Costs

We update our Telstra forecasts for the flagged restructuring costs of \$200-250m across FY24 and FY25 due to the reduction of up to 2,800 staff. We assume the midpoint of the range and apply \$100m in FY24 and \$125m in FY25. Note there is no change in our underlying forecasts and our underlying EBITDA of \$8.2bn and \$8.6bn in FY24 and FY25 remain consistent with the guidance ranges of \$8.2-8.3bn and \$8.4-8.7bn in each period. The restructuring costs only impact our statutory forecasts and the impact is 1% downgrades in EBITDA in FY24 and FY25. Note the restructuring costs are expected to be tax deductible and we have assumed so in our forecasts. The impact on statutory NPAT is downgrades of 3% and 4% in FY24 and FY25.

A summary of the changes in our key forecasts is shown below. There is no change in our DPS forecasts given the lack of change in our underlying forecasts.

Figure 1 - Change in key forecasts

Year end 30 June	FY24e			FY25e			FY26e		
	Old	New	Change	Old	New	Change	Old	New	Change
Total income (A\$m)	23,687	23,687	0.0%	24,122	24,122	0.0%	24,581	24,581	0.0%
Statutory EBITDA	8,221	8,121	-1.2%	8,599	8,474	-1.5%	8,924	8,924	0.0%
Underlying EBITDA	8,221	8,221	0.0%	8,599	8,599	0.0%	8,924	8,924	0.0%
Underlying diluted EPS	18.1c	18.1c	0.0%	19.5c	19.5c	0.0%	20.9c	20.9c	0.0%
DPS	18.0c	18.0c	0.0%	19.0c	19.0c	0.0%	20.0c	20.0c	0.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

1% Decrease in PT to \$4.20

Our overall view of the update last month was slightly net negative given the size of the job cuts suggests the \$500m cost reduction target by FY25 is proving difficult and the turnaround in Enterprise is likely to be slow. But the removal of annual CPI price rises for postpaid mobile price plans we did not view negatively – as it provides flexibility – and in our view does not indicate increased competition in mobile (as supported by the price rises by Optus in late May). We therefore increase the discount we apply in the PE ratio valuation from 5% to 15% and increase the WACC we apply in the DCF from 8.8% to 8.9%.

The change in each valuation and the impact on our PT calculation is shown below.

Figure 2 - Change in valuations and impact on PT

Methodology	Old (as at 12-Mar-24)			New (as at 24-Jun-24)		
	Valuation per share	% weighting	Price Target	Valuation per share	% weighting	Price Target
PE ratio	\$4.28	25.0%	\$1.07	\$4.05	25.0%	\$1.01
DCF	\$4.17	25.0%	\$1.04	\$4.21	25.0%	\$1.05
DDM	\$3.87	25.0%	\$0.97	\$3.85	25.0%	\$0.96
SOTP	\$4.69	25.0%	\$1.17	\$4.69	25.0%	\$1.17
Total			\$4.25			\$4.20

SOURCE: BELL POTTER SECURITIES ESTIMATES

The net result is a 1% decrease in our PT to \$4.20 which is still a 16% premium to the share price so maintain the BUY recommendation.

Looks Reasonable Value

24% PE Ratio Discount to Peers

Telstra is trading on an FY25 PE ratio of 18.6x based on our underlying forecasts which is a 24% discount to the average 24.4x of the peers as shown below. We view some discount as appropriate but in our view this looks excessive, particularly given the forecast mid to high single digit EPS growth over the next few years, strong market position and the potential for some or all of InfraCo to be sold in the medium term.

Figure 3 - Forward PE ratio of peers

	Ticker	Share price at			PE ratio	
		24-Jun-24	Market cap	Year end	FY24e	FY25e
Aristocrat Leisure	ALL	\$49.01	\$31.0bn	Sep	20.8x	19.3x
Coles Group	COL	\$17.10	\$22.9bn	Jun	21.2x	20.4x
CSL	CSL	\$292.01	\$141.1bn	Jun	31.6x	27.5x
Goodman Group	GMG	\$35.18	\$66.8bn	Jun	32.7x	29.3x
Wesfarmers	WES	\$65.30	\$74.1bn	Jun	28.9x	26.3x
Woolworths	WOW	\$33.53	\$41.0bn	Jun	24.0x	23.4x
Average					26.5x	24.4x

SOURCE: BLOOMBERG

Higher Yield than Peers

Telstra is trading on a forecast FY25 yield of 5.2% which is higher than all of the peers as shown below. We also believe this is supportive of the current share price.

Figure 4 - Forecast yield of peers

	Ticker	Share price at			Yield	
		24-Jun-24	Market cap	Year end	FY24e	FY25e
Aristocrat Leisure	ALL	\$49.01	\$31.0bn	Sep	1.6%	1.8%
Coles Group	COL	\$17.10	\$22.9bn	Jun	3.9%	4.1%
CSL	CSL	\$292.01	\$141.1bn	Jun	1.4%	1.6%
Goodman Group	GMG	\$35.18	\$66.8bn	Jun	0.9%	0.9%
Wesfarmers	WES	\$65.30	\$74.1bn	Jun	3.0%	3.3%
Woolworths	WOW	\$33.53	\$41.0bn	Jun	3.6%	3.2%
Average					2.4%	2.5%

SOURCE: BLOOMBERG

Majority of Earnings in Mobile and Infrastructure

We highlighted that one of the negatives of the update was the turnaround in Enterprise is likely to be slow. This, however, is of little concern as >90% of Telstra's EBITDA comes from the Mobile and Infrastructure businesses. While this is not so much a valuation argument, it shows the earnings are underpinned in areas which are not underperforming.

Figure 5 - % of underlying EBITDA from Mobile and Infrastructure

Year end 30 June	FY22	FY23	FY24e
Mobile + International + InfraCo + Towers EBITDA (A\$m)	6,333	7,296	7,829
as % of underlying EBITDA	87%	92%	95%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Telstra Group

Company Description

Telstra is a telecommunications and technology company that operates both in Australia and internationally. In Australia, the company provides a full range of communications services and competes in all telecommunications markets. Internationally, Telstra has a presence in over 30 countries with key focus on the Asia-Pacific region. The bulk of revenue and earnings, however, still comes from Australia (i.e. 90% or more).

Investment Thesis

We maintain our BUY recommendation on Telstra. Our investment thesis is based on:

- **Valuation:** Our 12 month price target for Telstra is \$4.20. The PT is generated from a blend of four valuation methodologies we apply to the company: PE ratio, DCF, DDM and SOTP. The PT is a 16% premium to the current share price and the total expected return (which includes the forecast dividend yield) is 21%.
- **Reasonable dividend yield:** We forecast the total dividend to increase from 17.0c in FY23 to 18.0c in FY24 which is consistent with the company's aim to both maximise and grow the dividend. This equates to a yield of 5.0% which is notably similar to if not higher than current 6 to 12 month term deposit rates. The dividend, however, is fully franked so the grossed-up amount is 25.7c which equates to a yield of 7.1%.
- **Growth outlook:** Telstra has guidance for underlying EBITDA of mid-single digit CAGR b/w FY21 and FY25. The CAGR b/w FY21 and FY23 was 9.0% so this suggests some slowing in growth in FY24 and/or FY25. We forecast growth of 3.4% in FY24 and 4.6% in FY25 which generates a CAGR of 6.5% b/w FY21 and FY25 so is consistent with the guidance. Notably the guidance for CAGR in underlying EPS b/w FY21 and FY25 is much greater at "high teens" and our forecasts are also generally consistent with this.

Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Focus on growth:** Telstra went through a transformation period as part of the T22 strategy and has now moved to a focus on growth as part of the T25 strategy. This change poses a level of inherent risk, including the design and delivery of products and services which may not sufficiently meet customers' needs. Telstra also operates in a competitive environment, and competitors may develop superior and/or differentiated products which compete more effectively.
- **Market and competition risks:** The telecommunications industry in Australia and internationally is competitive and subject to change (including accelerating technological change). The effect of competitive market conditions, including any decline in the pricing as well as the purchase and use of Telstra's products and services, may adversely impact earnings and assets.
- **Doing business responsibly:** "Doing business responsibly" is one of the key pillars in the T25 strategy and is also the foundation of Telstra's sustainability strategy. The risks with not conducting business responsibly include eroding community and customer trust in Telstra's standing as a responsible corporate citizen and damage its reputation with stakeholders through negative regulatory and financial implications.

Table 1 - Financial summary

Telstra Group (TLS)						Share price:	\$3.62	Target price:	\$4.20		
						No. of issued shares:	11,554m	Market cap:	\$41,827m		
Profit & Loss (A\$m)						Valuation data					
Year end 30 Jun	2022	2023	2024e	2025e	2026e	Year end 30 Jun	2022	2023	2024e	2025e	2026e
Revenue	21,277	22,702	23,117	23,581	24,053	Underlying NPAT (A\$m)	1,688	2,023	2,093	2,248	2,420
Other income	768	543	570	542	528	Underlying diluted EPS (Ac)	14.3	17.5	18.1	19.5	20.9
Total income	22,045	23,245	23,687	24,122	24,581	<i>Change</i>	48%	22%	3%	7%	8%
<i>Growth</i>	-5%	5%	2%	2%	2%	P/E ratio (x)	25.2	20.7	20.0	18.6	17.3
Total expenses	-14,758	-15,356	-15,541	-15,629	-15,642	CFPS (Ac)	55.7	53.0	55.0	59.7	62.5
<i>% of revenue</i>	-69.4%	-67.6%	-67.2%	-66.3%	-65.0%	Price/CF (x)	6.5	6.8	6.6	6.1	5.8
Share of net profit/loss from JVs	-31	-27	-25	-20	-15	DPS (Ac)	16.5	17.0	18.0	19.0	20.0
EBITDA (statutory)	7,256	7,862	8,121	8,474	8,924	Yield	4.6%	4.7%	5.0%	5.2%	5.5%
D&A	-4,358	-4,470	-4,526	-4,639	-4,755	Franning	100%	100%	100%	100%	100%
EBIT	2,898	3,392	3,596	3,835	4,169	Underlying EBITDA (A\$m)	7,251	7,950	8,221	8,599	8,924
Net interest expense	-417	-529	-622	-668	-635	EV/Underlying EBITDA (x)	7.9	7.2	6.9	6.6	6.4
Pre-tax profit	2,481	2,863	2,974	3,167	3,534	NTA per share (Ac)	76.3	59.1	66.8	77.5	89.9
Income tax expense	-667	-812	-818	-972	-972	Price/NTA (x)	4.7	6.1	5.4	4.7	4.0
NPAT	1,814	2,051	2,156	2,296	2,562	Performance ratios					
Non-controlling interests	-126	-123	-135	-139	-142	Year end 30 Jun	2022	2023	2024e	2025e	2026e
NPAT after NCI	1,688	1,928	2,021	2,157	2,420	EBITDA margin	34.1%	34.6%	35.1%	35.9%	37.1%
<i>Growth</i>	-9%	14%	5%	7%	12%	EBIT margin	13.6%	14.9%	15.6%	16.3%	17.3%
Cash Flow (A\$m)	2022	2023	2024e	2025e	2026e	Return on assets	4.4%	4.6%	4.7%	5.1%	5.9%
Year end 30 Jun	2022	2023	2024e	2025e	2026e	Return on equity	11.7%	13.3%	14.0%	14.9%	16.4%
EBITDA	7,256	7,862	8,121	8,474	8,924	ROIC	9.4%	10.4%	11.1%	12.3%	13.6%
Change in working capital	812	-127	-297	-30	-31	Payout ratio	114.9%	101.8%	102.9%	101.8%	95.5%
Gross cash flow	8,068	7,735	7,825	8,444	8,893	Effective tax rate	-26.9%	-28.4%	-27.5%	-27.5%	-27.5%
Income tax paid	-819	-933	-818	-871	-972	Leverage ratios					
Operating cash flow	7,249	6,802	7,007	7,573	7,921	Year end 30 Jun	2022	2023	2024e	2025e	2026e
Payments for PPE	-2,176	-2,474	-3,375	-2,300	-2,350	Net debt/(cash) (A\$m)	12,720	14,418	15,105	13,788	12,229
Payments for Intangibles	-918	-1,396	-1,500	-1,250	-1,250	Net debt/equity	75%	81%	84%	76%	66%
Payments for investments	-851	-2,595	-425	-100	-75	Gearing	43%	45%	46%	43%	40%
Proceeds from sale of PPE	155	201	150	100	100	Net debt/EBITDA (x)	1.8	1.8	1.9	1.6	1.4
Proceeds from sale of invest.	156	51	25	25	25	Net interest cover (x)	6.9	6.4	5.8	5.7	6.6
Distributions received	93	40	50	50	50	Segmentals (A\$m)					
Receipts of finance leases	92	82	75	75	75	Year end 30 Jun	2022	2023	2024e	2025e	2026e
Government grants	24	58	25	25	25	Product income (A\$m)					
Interest received	14	37	50	50	50	Mobile	9,470	10,258	10,771	11,256	11,706
Other	16	45	0	0	0	Fixed - C&SB	4,486	4,457	4,390	4,335	4,292
Investing cash flow	-3,395	-5,951	-4,925	-3,325	-3,350	Fixed - Enterprise	3,697	3,636	3,454	3,368	3,326
Proceeds/repayment of debt	-2,280	1,560	1,000	-500	-1,000	Fixed - Active Wholesale	477	403	363	326	294
Payment of lease liabilities	-697	-675	-650	-675	-700	International	1,501	2,429	2,672	2,805	2,946
Finance costs paid	-534	-636	-672	-718	-685	InfraCo Fixed	2,456	2,556	2,748	2,885	2,957
Dividends paid	-1,988	-2,127	-2,022	-2,138	-2,253	Amplitel (Towers)	368	401	461	484	508
Other	2,883	930	0	0	0	Other	700	1,076	1,076	1,022	971
Financing cash flow	-3,971	-969	-2,344	-4,031	-4,638	Elimination	-1,575	-2,043	-2,047	-2,360	-2,419
Net change in cash	-117	-118	-262	217	-66	Underlying income	21,580	23,173	23,687	24,122	24,581
Cash at start of period	1,125	1,040	932	670	887	One-off nbn DA and connection	378	72	0	0	0
Exchange rate impact	32	10	0	0	0	Guidance adjustment	87	0	0	0	0
Cash at end of period	1,040	932	670	887	821	Reported income	22,045	23,245	23,687	24,122	24,581
Balance Sheet (A\$m)	2022	2023	2024e	2025e	2026e	Product EBITDA (A\$m)					
Year end 30 Jun	2022	2023	2024e	2025e	2026e	Mobile	3,997	4,602	5,008	5,206	5,385
Cash	1,040	932	670	887	821	Fixed - C&SB	55	135	220	217	215
Current receivables	4,074	4,216	4,508	4,598	4,690	Fixed - Enterprise	660	411	173	210	249
Inventories	476	546	578	590	601	Fixed - Active Wholesale	159	117	100	90	81
Other current assets	670	1,039	1,039	1,039	1,039	International	387	713	735	786	840
Non-current receivables	861	1,017	1,156	1,179	1,203	InfraCo Fixed	1,655	1,663	1,717	1,803	1,848
Investments	829	708	1,033	1,033	1,008	Amplitel (Towers)	294	318	369	387	407
PPE	20,485	20,969	21,931	21,812	21,684	Other	44	-9	-100	-100	-100
Intangibles	8,155	10,989	10,226	9,157	8,029	Underlying EBITDA	7,251	7,950	8,221	8,599	8,924
ROUA	2,926	2,825	2,825	2,825	2,825	One-off nbn DA and connection	233	37	0	0	0
Other non-current assets	2,112	1,788	1,788	1,788	1,788	Restructuring/M&A	-71	-91	-100	-125	0
Total assets	41,628	45,029	45,754	44,907	43,688	Other guidance adjustments	-157	-34	0	0	0
Current payables	4,209	4,365	4,623	4,716	4,811	Reported EBITDA	7,256	7,862	8,121	8,474	8,924
Current provisions	827	1,011	1,011	1,011	1,011	Interims (A\$m)					
Current lease liabilities	650	775	775	775	775	Year end 30 Jun		1HFY23	2HFY23	1HFY24	2HFY24e
Current borrowings	3,180	3,110	3,110	3,110	3,110	Revenue		11,306	11,396	11,425	11,692
Current other liabilities	1,482	1,606	1,606	1,606	1,606	Other income		277	266	295	275
Non-current provisions	251	311	311	311	311	Total income		11,583	11,662	11,720	11,967
Non-current lease liabilities	2,797	2,743	2,168	1,568	943	<i>Growth</i>		6%	5%	1%	3%
Non-current borrowings	8,292	10,013	11,013	10,513	9,513	Total expenses		-7,723	-7,633	-7,698	-7,843
Deferred tax liabilities	1,678	2,112	2,112	2,112	2,112	<i>% of revenue</i>		-68.3%	-67.0%	-67.4%	-67.1%
Non-current other liabilities	1,936	1,942	1,850	1,852	1,854	Share of net profit/loss from JVs		1	-28	-15	-10
Total liabilities	24,652	27,213	27,804	26,799	25,271	EBITDA (statutory)		3,861	4,001	4,007	4,114
Share capital	3,098	3,095	3,095	3,095	3,095	<i>Growth</i>		11%	6%	4%	3%
Reserves	2,333	2,196	2,196	2,196	2,196						
Retained earnings	10,057	10,116	10,115	10,134	10,301						
Non-controlling interests	1,488	2,409	2,544	2,683	2,825						
Total shareholders' equity	16,976	17,816	17,950	18,108	18,418						

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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