

# Telstra Limited (ASX: TLS)

## A company in an earnings downgrade cycle

Unless you are from another country, you'd know who Telstra is. As Australia's largest telecommunications company, it dates back almost a century to when telephones were introduced into Australia. It has more than 17 million mobile users, close to 7 million fixed voice services and 3.5 million retail broadband services. The company is focused on building technology and content solutions primarily on their national mobile network.

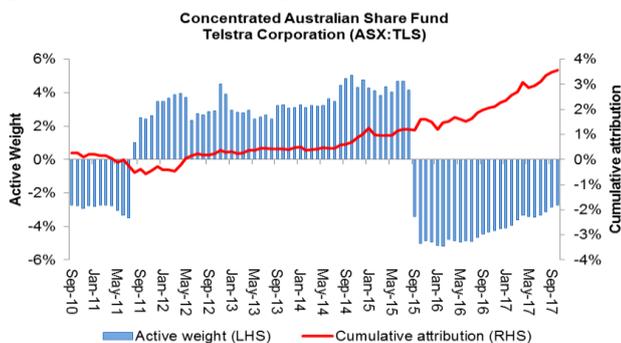


### Telstra's positioning in the portfolio

Back in 2010, at the inception of Alphinity, the portfolios were well underweight Telstra. The company was in downgrade mode after its then-new CEO was in the process of resetting earnings expectations to more achievable levels. The stock at that time appeared very cheap (Price/Earnings (P/E) 10x, dividend yield 10% and share price below \$3) however the outlook for earnings was weak.

A glimmer of hope first showed at the FY11 result, which resulted in most market analysts upgrading their earnings forecasts. The valuation was still very cheap and our research suggested that the market was being too conservative. Seeing the upgrades beginning to come through we went overweight. It was the correct decision. In our experience, an upgrade often precedes another: the upgrade cycle had begun.

Figure 1: Portfolio positioning and cumulative attribution



Source: Alphinity

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We maintained an overweight position between 2011 and 2015, during which time Telstra delivered earnings which consistently beat market expectations. The stock enjoyed such a strong re-rating that it became relatively expensive, with a P/E around 17x, a yield below 5%, and a share price well over \$6.

### The decision to sell

By August 2015 the market was, in our view, increasingly at risk from heightened competition in the mobile phone market. At that point we assessed that the earnings expectations of the market were unachievable and went back to a large underweight position which we have maintained ever since. Subsequent developments around the NBN have exacerbated the downgrade trend. The chart below demonstrates how correlated share prices are to earnings expectations.

Figure 2: TLS Share price vs earnings estimates



Source: Bloomberg, Alphinity

### Where to from here for Telstra?

Telstra currently appears quite cheap on some valuation metrics (P/E 11x, share price \$3.50), although it has a declining earnings outlook and its annual dividend has been cut from 31c to 22c, removing some of the yield support. However, the Alphinity process ensures that we will patiently wait until our research shows it has the potential to return to an earnings upgrade cycle. At that point, providing its valuation is attractive, we will consider moving to an overweight position again.

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