Credit Risk Analysis: Telus (TSX:T)

Team CDGR

Scotiabank®

Proposed Deal Overview

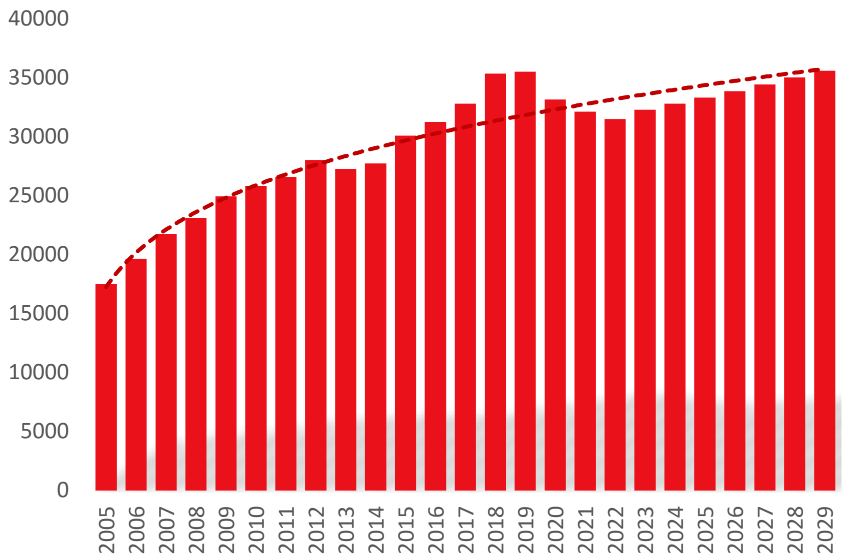
Borrower	TELUS Corporation (TSX: T)
Non-Revolving Credit Facility	Amount: USD 1,100,000,000 (Scotia as Co-Lead, Renewal of 2022 Credit Facility*) Term Expiration: 2 years Payback period: 1 year
Use of Proceeds	Repayment of outstanding indebtedness General corporate purposes
Pricing	SOFR (Secured Overnight Financing Rate) + Applicable Margin SOFR Rate: 5.31% (2024-01-24) A: **-7 bps** / BBB: **34 bps** [Current Rating: BBB]
Financial Covenants	External Rating Remains **Investment Grade** Net Debt/EBITDA <= **4.25X** Cash Flow from Operations (CFO) to Interest Expense Ratio >= **2X** Ratio Test conducted **Quarterly**
Undrawn Fee	35% of Applicable Margin (Subject to non-negative constraint)
Annual Review Fee	35% of Applicable Margin (Subject to non-negative constraint)
Interest Payment Schedule	Quarterly
Covenant Violations	Immediate outstanding amount payback and the termination of Facility Change of Control: Repurchase at 101%

* Telus has a $1.1 billion unsecured non-revolving credit facility with a term expiring in July 2024, underwritten by Scotia and CIBC

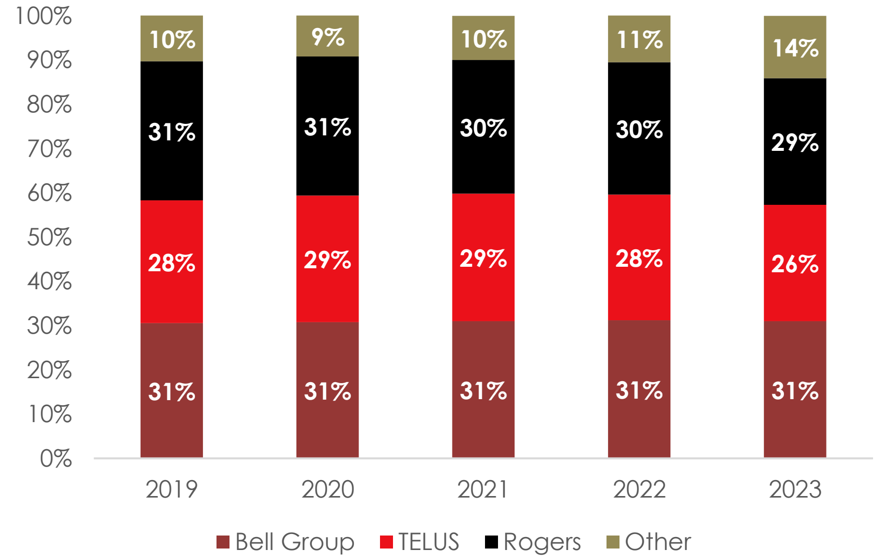
References:
Capital IQ (credit curve data)
New York Fed, https://www.newyorkfed.org/markets/reference-rates/sofr

Telecom Industry in Canada

Industry Revenue($ million)



Market Share (%) 2019-2023



Observations:

- **Industry Revenue Growth**: Industry revenue shows a steady upward trend, with projections suggesting sustained growth at a rate roughly in line with population growth (1-2% YoY) in the foreseeable future.
- **Market Competitive Landscape**: Though the Big 3 are still the market leader, but competition remains fierce as “digitally focused brands” (e.g. Freedom) often price aggressively. Moreover, the Big 3 compete among themselves as well.

Reference: IBISWorld | https://my-ibisworld-com.myaccess.library.utoronto.ca/ca/en/industry/51711cca/at-a-glance

Company Overview

Company Highlights

- **Company History:** Incorporated in 1998; headquartered in Vancouver, Canada
- **Major Business Segments:** TELUS Technology Solution (**TTech**) & Digitally-led Customer Experience (**DLCX**)
- **Market Share:** 26.3% of the Industry Market Share; 3rd largest Telecom Carrier in Canada
- **Stock Trading:** Dual-listed on TSX (T) and NYSE (TU)
- **Ownership:** 53.8% Institutions; 46.07% Public;

Business Priorities & Strategies

Mobile:

- enhancing 5G connectivity;
- strengthening business and public service offerings

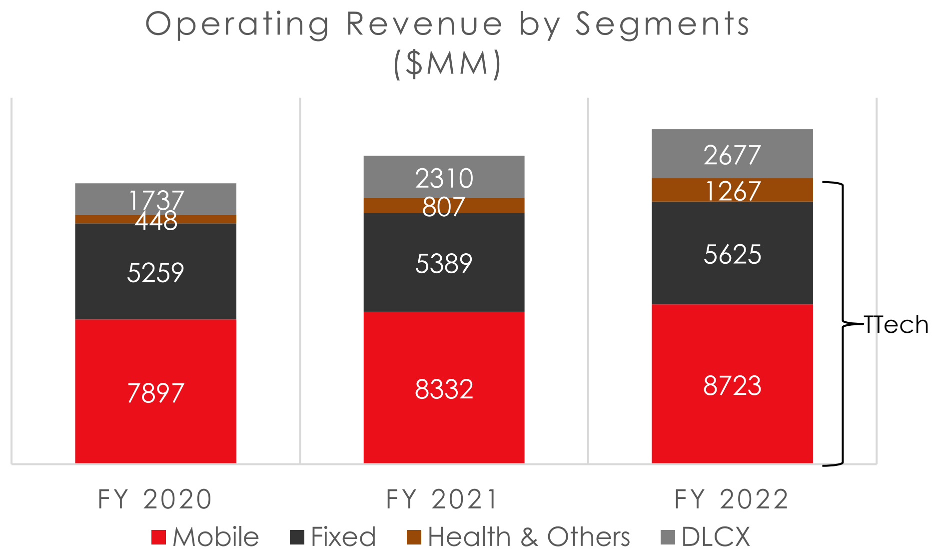
Fixed Fiber:

- expand TELUS PureFibre network;
- grow customer base through bundled product offerings

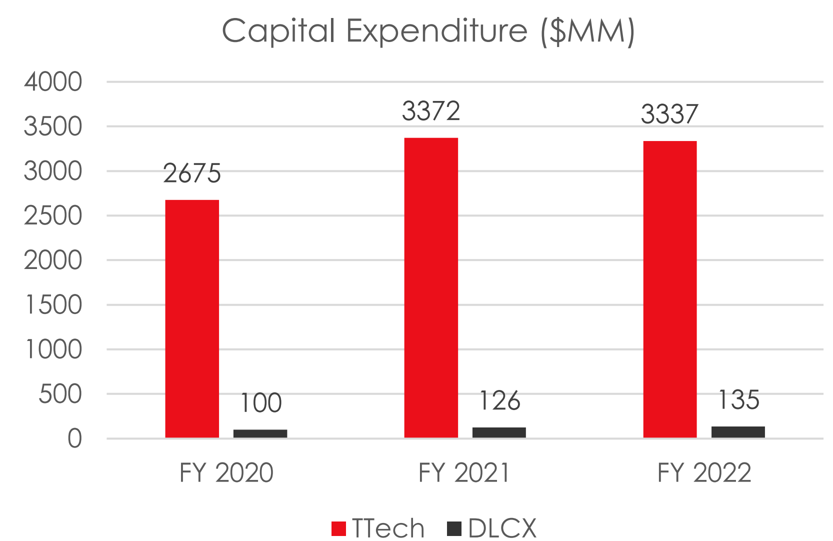
Fixed non-Fiber:

- promote security and cloud-based solutions, as well as IoT connectivity;
- solidifying TELUS Health in digital health solutions market

Core Business

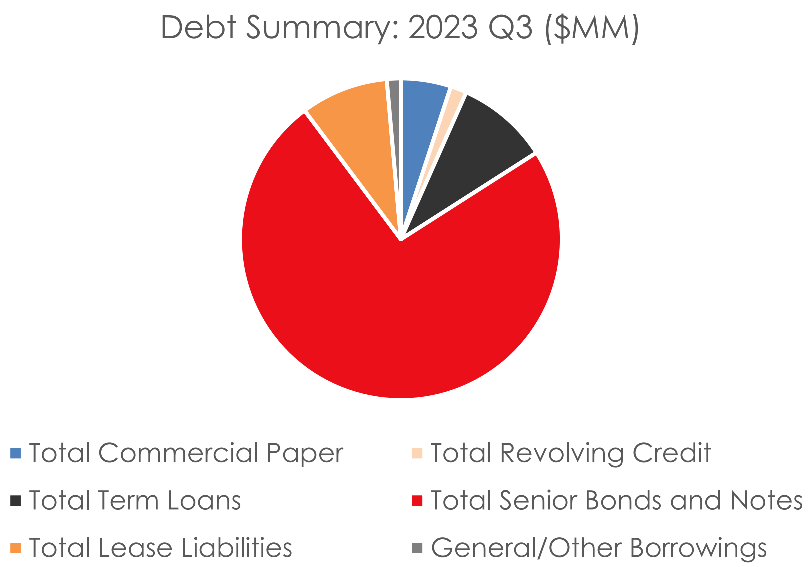


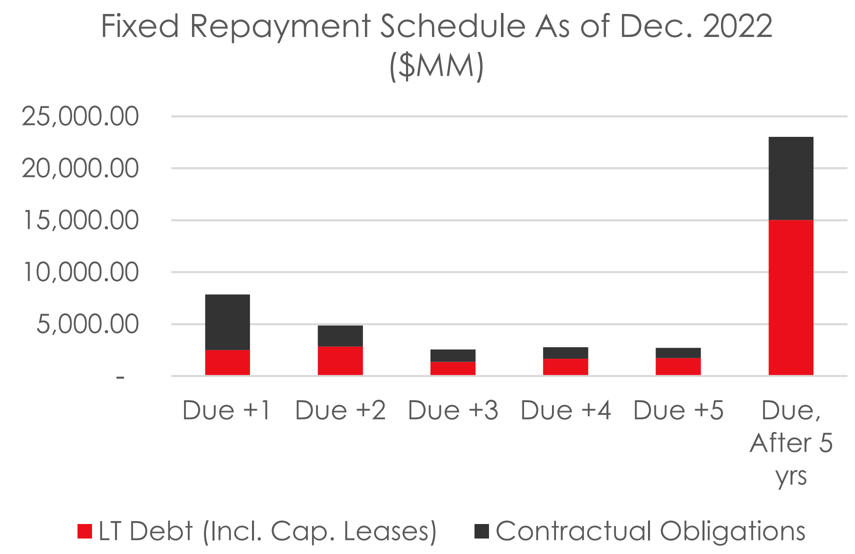
Telus has Maintained Stable CAPEX Spending



Debt Structure & Covenant Compliance

Debt Structure

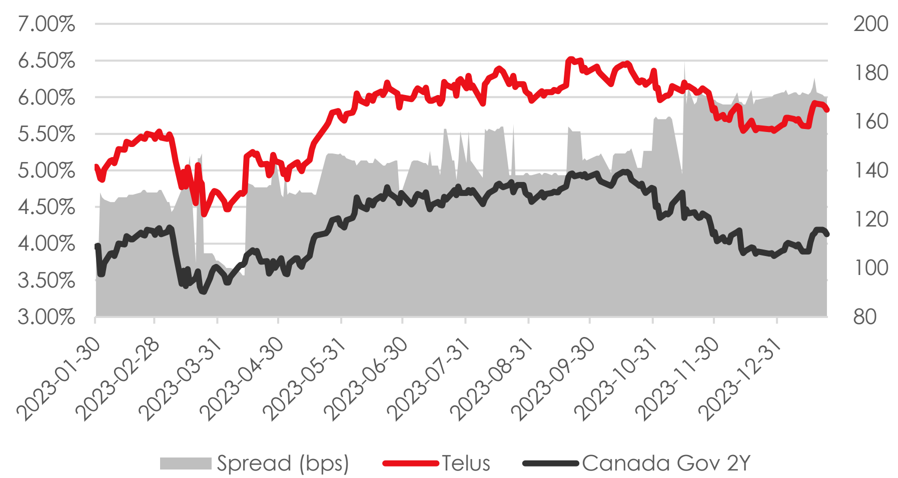




Covenant Compliance Check

- **Credit Facilities:**
  - Consolidated leverage ratio cannot exceed 4.25x
  - Consolidated coverage ratio cannot be less than 2.00x
  - Company is in well compliance with the **leverage ratio (3.63x)** and **coverage ratio (7.85x)**

Benchmark Bond Performance



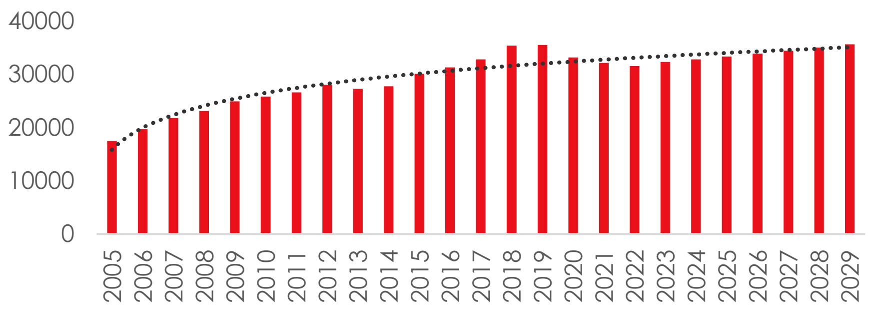
TELUS 2022 Financial Performance

Unit: $MM	2020	2021	2022	Y/Y
Total Revenue	$15,341	$16,838	$18,292	8.6%
Total Gross Profit	$5,615	$6,030	$6,518	8%
Gross Profit Margin %	36.6%	35.8%	35.6%	(20 bps)
EBITDA	4,696	4,993	5,400	8.15%
EBITDA Margin %	30.6%	29.7%	29.5%	(20 bps)
EBIT	2,630	2,825	3,080	9.03%
EBIT Margin %	17.1%	16.8%	16.8%	-
Net Income	$1,207	$1,655	$1,615	(2.4%)
Net Income Margin %	7.9%	9.8%	8.8%	(100 bps)
Return on Assets %	4.0%	3.9%	3.8%	(10 bps)

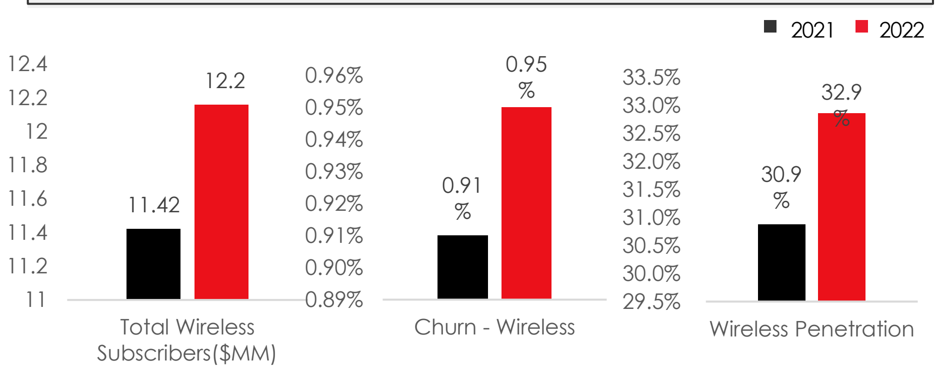
Annual Financial Highlights

•**Robust Revenue Growth**: A robust revenue increase of 8.6% year-over-year reflecting strong customer retention and acquisition in a competitive telecom landscape. (In comparison to its peers, Bell and Rogers, which reported a revenue growth of 3.1% and 5.1%, Telus performs better.)
•**Resilient Profitability:** Despite the increase in Employee benefit expense, the gross profit margin stands strong at 35.6%.
•**Stable EBITDA Margin**: Despite a minor decrease, the EBITDA Margin remains steady, indicating TELUS's excellent operational capabilities.

Revenue($MM)



Operating Metrics



Reference: Capital IQ & Proprietary Data

Financial Projections Assumptions

Item	Assumption
Revenue	• TTech mobile products & services growth revenue reflects mobile subscriber growth, higher roaming margins associated with increased international travel volumes and higher equipment margins with an expected rate of ~10% annually • DLCX revenue growth reflect growth in tech, games, eCommerce, fintech & additional services provided to existing and new clients
ARPU	• ARPU reflects a slight decline of ~0.5% considering the increase of competition
TELUS International	• TELUS international (DLCX) revenue (comprised of digital customer experience, digital-enablement transformation solutions including artificial intelligence & content management) is expected to grow
Operating Costs	• Goods & services purchased - effectiveness programs help improve overall cost efficiency • Employee benefits expense increase due to expansion of DLCX team member base to service growing volumes & changes in external labor requirements to support the digital growth • Depreciation reflects increases related to capital assets acquired in business operations
Capital Structure	• Maintains a stable balance between debt and equity
Interest Expense	• Interest rates are expected to decrease, which partly offsets the growth in total debt. Overall, the interest expense is still expected to increase.

Financial Projections – Key Items

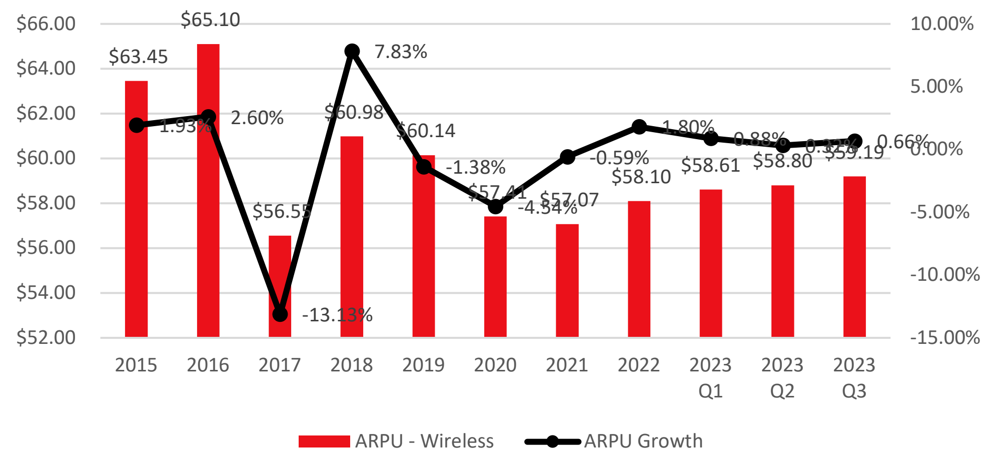
Fiscal Period	FY2026	FY2025	FY2024	FY2023	FY2022
Revenue Mix					
TELUS Technology Solutions	$22,886.81	$20,806.19	$18,914.72	$17,195.20	$15,632.00
Digitally-Led Customer Experiences TELUS International	$5,819.39	$5,016.72	$4,324.76	$3,728.24	$3,214.00
Eliminations (intersegment Revenue)	-$1,148.77	-$957.31	-$797.76	-$664.80	-$554.00
Total Revenue	$27,557.43	$24,865.60	$22,441.72	$20,258.64	$18,292.00
Gross Profit	$9,877.84	$8,894.18	$8,015.32	$7,221.68	$6,518.00
Other Operating Exp., Total	$5,685.82	$5,146.22	$4,653.97	$4,023.08	$3,438.00
EBITDA	$10,373.52	$9,025.78	$7,903.23	$7,233.68	$6,523.00
EBITDA Margin	37.64%	36.30%	35.22%	35.71%	35.66%
Net Interest Exp.	-$1,261.73	-$1,142.97	-$1,038.32	-$927.94	-$838.00
EBT Excl. Unusual Items	$3,121.29	$2,789.15	$2,508.82	$2,458.66	$2,453.00
Cash From Operations To Debt	22.99%	21.69%	20.30%	20.00%	13.22%
Debt to EBITDA	3.95	4.24	4.53	4.58	5.58
EBITBDA to Interest	8.22	7.90	7.61	7.80	7.78
EBIT to Interest	3.32	3.28	3.24	3.45	3.68

Risk Factors – Intense Competition

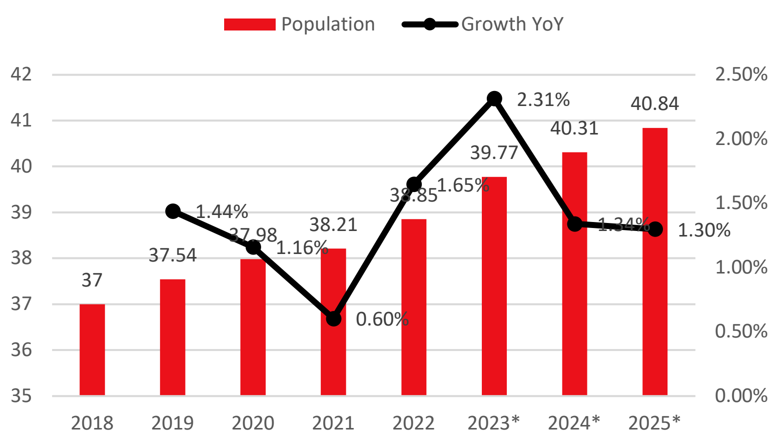
Risks & Mitigants

- **Risk: Intense Competition Caused ARPU Growth Slowdown**
  - In **wireless** section, there is a spike in promotional discounting in the end of 2023
  - In **wireline** section, there is heightened competition from Rogers in non-fiber markets
- **Mitigant: Population Growth Fueled Net Additions**
  - Internet and phone plan is a must for many new immigrants to Canada
  - In addition to penetration rate growth, Net Additions of Telecom companies also benefits from this immigrant inflow

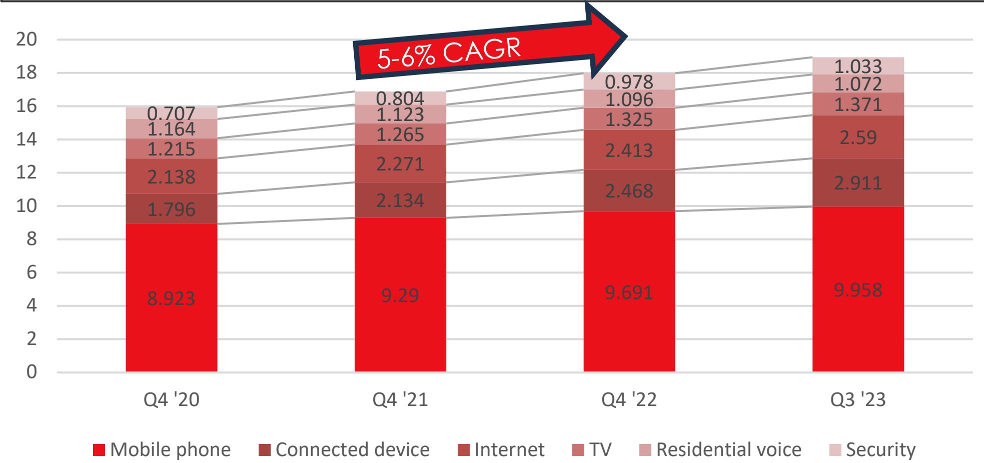
Intense Competition Caused ARPU Growth Slowdown



Population Growth Supported by Immigration



…And it in turn fueled Net Additions



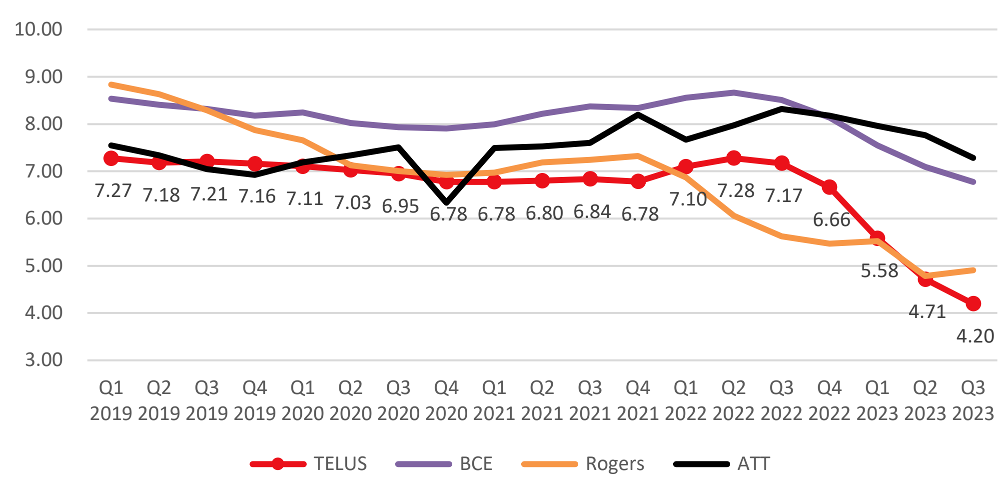
References:
Statista, StatsCan, Company Reports

Risk Factors – Financial Risks

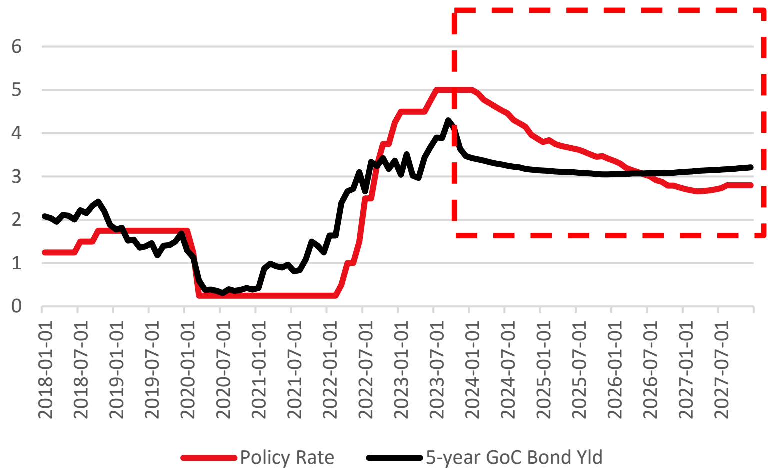
Risks & Mitigants

- **Risk: TELUS has a rising leverage and lower than peer capability to cover short term obligations**
  - In a short-term view, TELUS has a lower coverage ratio than peers
  - In a long-term view, TELUS' Debt/Equity Ratio is also on the rise
- **Mitigant: BoC rate cut is expected to start in 2024**
  - According to BoC's projection in its working paper, the long-awaited rate cut may start in this year, which gives relief to the coverage ratio by lowering average finance costs

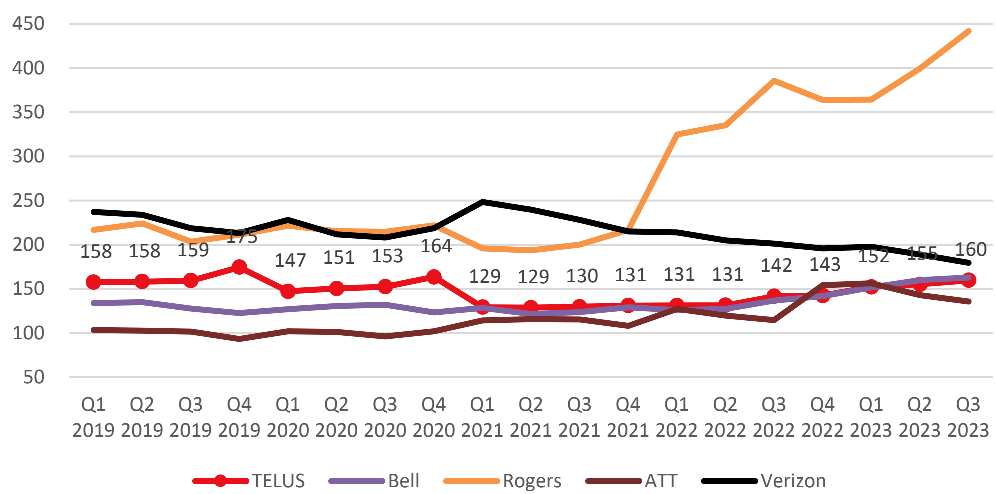
TELUS EBITDA Coverage Ratio is lower than peers



BoC rate cut is expected to start in 2024



TELUS Debt/Equity Ratio is also on the rise



References:
Company reports, Bank of Canada Working Paper

Risk Rating and Recommendation

Risk Level	**Low Business Risk:** 1) national market leader and telco has high barrier to entry 2) actively adopting new technology 3) national network coverage 4) diversification into other business enforced the "moat" **Medium Financial Risk**: 1)rising leverage 2)low coverage 3)rate cut (and cost efficiency program) could be mitigants The overall risk score is **3.64**, which roughly corresponds to a BBB rating
Recommendation	**Recommendation**: We recommend to renew the non-revolving credit facility for another two years. **Reasonability**: Given the upcoming rate cut expectation, Telus may take the facility as stopgap funding alternative to avoid locking a higher costs via issuance of medium to long term notes. Therefore, extending the facility is a reasonable ask from Telus.
Ancillary Business Opportunities	- Scotia can ask for more hedging business (FX, interest rate). - Scotia can be the sole-lead (or take a larger share as Co-lead) when Telus will refinance its corporate bonds in 2025 and beyond. - Scotia may ask for M&A advisory from Telus in the future when needed.

Appendix

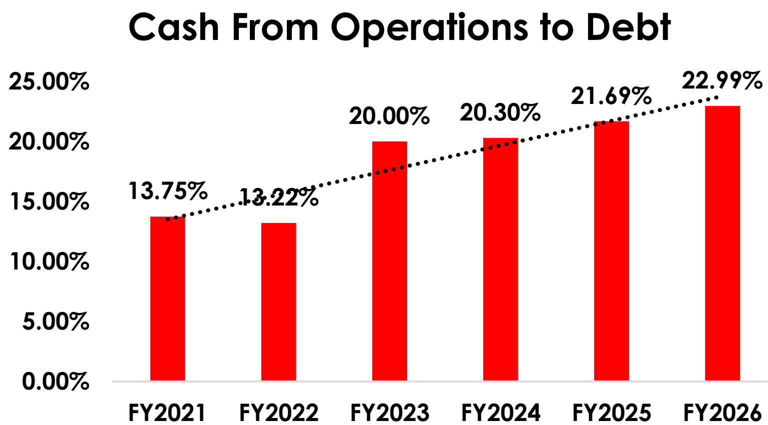
Credit Risk Rating Assessment Scorecard

Type	Criteria	Weight	5	4	3	2	1	Value	Score
Business Risk Assessment	Competitive Environment	12.0%	*No Competition *3 or less national operators	***Similar to 5, but with smaller regional players**	*3-6 operators *modest competition	*more than 6 players	*Highly Competitive	3 National + regional	4
	Technology	12.0%	***Provide huge advantage *Barrier remain high**	*Provide modest advantage *Barrier remain high, modest threat	*Barrier remain modest	*not benefit from latest tech *Barrier remain modest	*not benefit from latest tech *threat remain high	huge advantag e and barrier	5
	Networks	12.0%	***full suite service *cover entire region *network has clear advantage**	*close to full service *cover most region *network has advantage	*close to full service *growing coverage *network has advantage in few services	*a few services *slow-growing coverage *network has minor advantage	*a few services *low penetration *network has no advantage	full service + entire Canada	5
	Diversification (Products/Markets)	12.0%	*Ample ability to bundle service in all coverage areas	***sufficient ability to bundle service in most coverage areas**	*adequate ability to bundle service in many coverage areas	*modest ability to bundle service in many coverage areas	*limited ability to bundle service in any coverage areas	bundle in most areas	4
	Regulation	12.0%	*supportive of high barrier *limits competition	***relatively supportive of high barrier *moderately promote competition**	*balanced policy of barrier and competition	*supports competitive environment	*Strongly supports competition	Balanced Policy	4
Financial Risk Assessment	Cash flow-to-debt	10.0%	>60%	30-60%	20-30%	**10-20%**	0-10%	15.41%	2
	Debt-to-EBITDA	10.0%	<1x	1-2x	2-3.5x	**3.5-5x**	5-8x	5.5x	2
	EBITDA-to-interest	10.0%	>10x	7-10x	**4-7x**	2-4x	1-2x	4.2x	3
	EBIT-to-interest	10.0%	>8x	5-8x	**3-5x**	1.5-3x	0.5-1.5x	2.5x	3

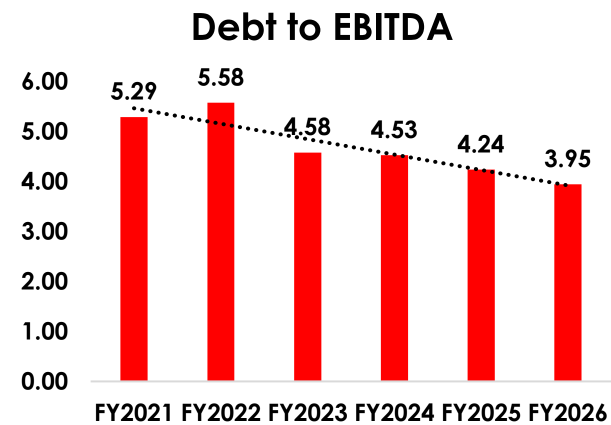
Rating: 4.5-5 AA / 3.75-4.5 A / 2.5-3.75 BBB / 1.5-2.5 BB / 1.0-2.0 B

Financial Projections – Credit Metrics

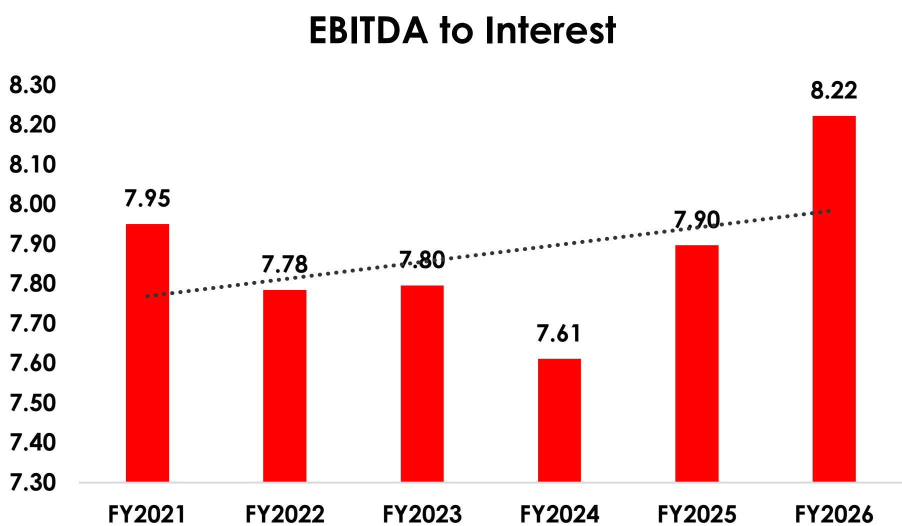
Growing Debt Servicing Ability



Greater Capacity to Cover Debt Obligations



Greater Capacity to Meet Interest Obligations



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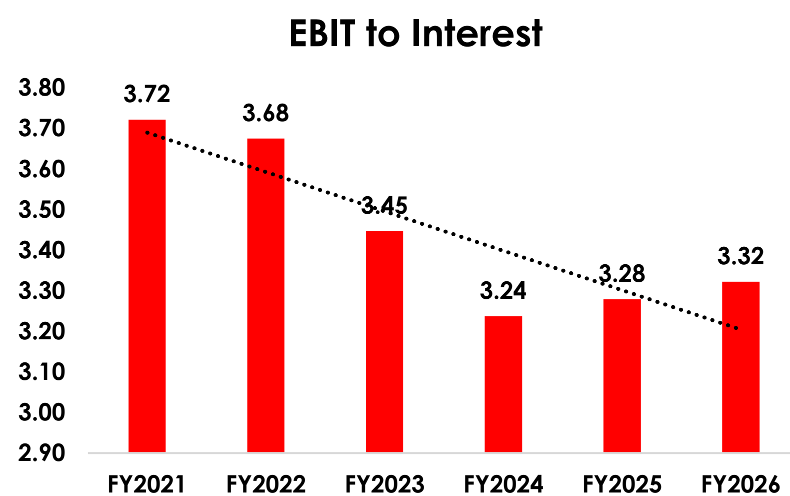

Yield Curve and Telus Benchmark Bond

Term	BBB	A	UST	Spread BBB	Spread A
3M	5.69%	5.28%	5.4%	34	-7
1Y	5.71%	5.29%	4.8%	95	53
2Y	5.50%	5.08%	4.3%	119	77
5Y	5.08%	4.67%	4.0%	106	65
10Y	5.49%	5.07%	4.1%	137	95