AT&T

AT&T Inc.		**Industry View:**	**UNATTRACTIVE**		
Latest Results:	2012 Q1	**Company Rating:**	LOW	MED.	HIGH
Country:	USA	Risk			
Sector:	Telecoms	Quality			
RIC (Ticker):	T.N	Valuation			

INDIGO EQUITY RESEARCH

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Company Profile

Mixed 2012 Q1 results - EPS growth target will be a strectch

- **Q1 EPS growth was mediocre at 5%, driven by revenue growth & lower depreciation. Guidance is for "mid-single-digit" earnings growth from higher revenues & margins. This looks very optimistic given that revenue growth is slowing as US wireless markets reach saturation and depreciation may rise - to be back in line with CAPEX.**

- Total revenue rose modestly by $0.6 bn (+2%), to $31.8 bn, as existing trends continued.
  - Wireless revenue rose by $0.8 bn (+5%), to $16.1 bn.
  - **Subscriber growth slowed to 7%; while ARPU fell again by 3%. Subscriber growth was primarily in pre-paid, devices (iPads) and resellers. Few post-paid subscribers were added due to stronger (iPhone) competition from Verizon.**
  - **AT&T Wireless is hampered by poor dynamics: data revenue growth appears to be stabilising at c. 20%, but data traffic on its mobile networks is doubling each year (requiring heavy CAPEX) and voice revenues are now contracting.**
  - Wireline revenue fell by $0.1 bn (-1%), to $14.9 bn; and continued to stabilise.
- EBITDA rose by $0.3 bn (+3%), to $10.7 bn. EBITDA Margin rose by 0.3% to 33.5%.
  - Wireless EBITDA rose by $0.6 bn (+11%), to $6.1 bn. Margins rose by 1.9% to 37.5%.
  - Wireline EBITDA fell by $0.1 bn (-1%), to $4.6 bn. Margins were flat at 31.0%.
- EBIT rose by $0.3 bn (+5%), to $6.1 bn. EBIT Margin rose by 0.6% to 19.2%.
  Higher EBIT margins resulted from flat depreciation costs, which amounted to 14% (down from 18% in 2008); but average CAPEX has remained at c.15-17% of sales.
- Net income rose by $0.2 bn (+5%), to $3.6 bn. Similarly, EPS rose by $0.03 (+5%), to $0.60.
- FCF fell -2%, to $3.5 bn due to negative working capital, despite lower CAPEX.

Note: Comparisons (eg. growth rates) are stated on a year-on-year basis.

Significant recent events

- AT&T faces a possible strike by wireline workers.
- AT&T to sell its Advertising Solutions and AT&T Interactive to Cerberus Capital for $950m.

Investment thesis

AT&T is a utility with a high dividend yield (c. 5-6%) and a value stock investment profile. It has a significant position market which generates strong recurring revenues & cash flows. However, AT&T has a weak financial track record; since 2000, EPS has been broadly static. Its focus on a mature US telecoms market means that It has limited ability to grow revenues. Its high dividend pay-out ratios of c. 75% restrict the potential for future dividend increases. Negative industry trends such as intensifying competition, commoditisation of services and loss of pricing power, is leading to greater margin pressure and AT&T becoming just a "dumb pipe". Value is shifting from telecoms networks to the content delivered by them (eg. Facebook ….). **In our opinion, AT&T's outlook is limited. It is likely that revenues will start to decline as the US telecoms market matures, similar to the contractions seen in Europe since 2005.**

SWOT analysis

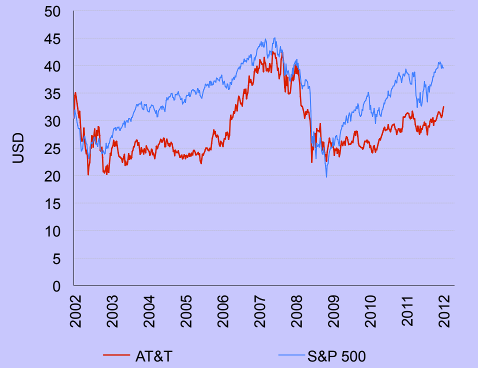
Strengths
- Large size (economies of scale).
- #2 US wireless market position.
- Strong free cash flow generation.
- High dividend yield; but high pay-out ratio.

Weaknesses
- Loosing ground to Verizon Wireless.
- Poor financial performance.
- Overloaded wireless network.
- Lack of wireless spectrum.

Opportunities
- Broadband services eg. U-Verse & LTE.
- Cost cutting; from network sharing, NGN (all-IP network) build & headcount reductions.
- Bundling (fixed line, internet, TV & wireless).

Threats
- Telcos becoming "dumb pipes".
- Increasing competition; from Clearwire, cable operators, VoIP and WiFi.
- Maturing US market.

Share Price - Last 10 Years



Capital Structure	Per Share ($)	Total ($ Bn)
Share Price	**32.5**	
Number of Shares (bn)		5.9
Market Capitalization		192.7
Net (Debt) / Cash	-10.7	**-63.3**
Enterprise Value (EV)	43.8	259.4
Net Debt / Market Cap.		33%
Main Shareholder:		-

		Consensus Estimates	
Financial Results	**2011**	**2012e**	**2013e**
y/e 31 Dec	($ Bn)	($ Bn)	($ Bn)
Sales	126.7	128.2	130.6
EBIT	9.2	24.2	25.6
Net Income	3.9	14.0	14.8
Share Capital	105.5	99.5	103.0
Total Assets	270.3	261.3	265.0
Per Share Data	**2011**	**2012e**	**2013e**
EPS ($)	0.67	2.37	2.50
DPS ($)	1.73	1.77	1.80
Cash EPS ($)	2.45	2.14	2.20
Book Value ($)	17.80	16.81	17.41
Efficiency Analysis	**2011**	**2012e**	**2013e**
EBIT Margin	7.3 %	18.9 %	19.6 %
Net Profit Margin	5.4%	10.9%	11.3%
Asset Turnover	46.9%	49.1%	49.3%
Net Gearing	256.2%	262.6%	257.3%
Return on Equity	6.5%	14.1%	14.4%
Net Gearing = Net Assets / Share Capital & Reserves			
Growth Analysis	**2011**	**2012e**	**2013e**
Sales	2.0 %	1.2 %	1.9 %
EBIT	-52.9 %	162.7 %	5.6 %
Net Income	-80.1 %	255.0 %	5.8 %
DPS	2.4 %	2.3 %	1.7 %
Valuation Ratios	**2011**	**2012e**	**2013e**
EV / Sales	2.0	2.0	2.0
EV / EBIT*	21.4	10.7	10.1
P / Sales	1.5	1.5	1.5
P / EBIT*	15.9	8.0	7.5
PE*	28.1	13.8	13.0
PEG	-	0.1	2.2
P / BV	1.8	1.9	1.9
P / FCF	13.3	15.2	14.8
EV / Assets Value	1.0	1.0	1.0
Dividend Yield	5.2 %	5.4 %	5.5 %
Div. Pay-out Ratio	260.0 %	74.8 %	71.9 %
Net Debt / EBITDA	2.1	1.5	1.4

** = Excluding Unusual Items*

P = Price; BV = Book Value; FCF = Free Cash Flows

  Sources: AT&T, Indigo Equity Research, , Bloomberg

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Explanations and Definitions

Brief business description - AT&T

AT&T is the largest US integrated telecoms operator by revenues and a member of the S&P 500 Index.
Its major business lines include: wireline (fixed line) and wireless (mobile telephony), internet & IT services.
The corporate headquarters are in Texas and AT&T mobility is based in Atlanta. It has c. 250,000 employees.

Explanation of Company Ratings used by Indigo Equity Research Ltd:

Industry View: **ATTRACTIVE**

Company Rating:

	LOW	MED.	HIGH
Risk	■		
Quality		■	
Valuation			■

Industry View = This is an assessment from an investor's perspective of the potential for the industry as a whole to generate profits in the future based on criteria such as: market structure (eg. number of competitors and industry concentration), growth prospects, maturity (stage of the industry life cycle), regulations, technology, disruptive forces, expected changes and speed of any changes.

Risk = Risk of earnings disappointment & volatility as well as the risk of a change in the valuation ratios (or multiples) that impact the share price. This in turn depends on items such as revenue growth and profit margin volatility.

Quality = Quality of the company to maintain competitive advantages and pricing power, based on criteria such as management, market position, pricing power, market growth, quality of services etc…..

Valuation = Absolute measure of valuation multiples of the company, based on a range of metrics (multiples) such as: P/Sales, PE, PEG, P/BV, P/ FCF, EV/EBITDA, EV/Sales, Div Yield …..

Comment on Ratings: These qualitative assessments of "Company Ratings" are made for each company on a relative basis compared to other companies with large capitalizations.

Financial definitions & abbreviations:

FCF = Free Cash Flow
Op FCF = Operating Free Cash Flow
EBIT = Earnings Before Interest & Tax (ie. Operating Income)
EBITDA = Earnings Before Interest, Tax, Depreciation & Amortisation
12m av. = 12 month average (ie. Average for the last 12 months.)
y/e = (financial) year end
EV = Enterprise Value
P = (Share) Price
PE = Price / Earnings
PEG = PE / Growth
BV = Book Value
Div. = Dividend
EPS = Earnings Per Share
DPS = Dividends Per Share

Explanation of what constitutes an unusual or significant item: Indigo Equity Research determined what constituted "Unusual items" in this report on the basis of assessing what items were significantly or materially separate or different to the Company's core business and activities. This a highly subjective assessment made by the analyst on a case-by-case basis.

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