AT&T

AT&T Inc.		**Industry View:**	**NEUTRAL**
Latest Results:	**2012 Q2**	**Company Rating:**	
Country:	USA		
Sector:	Telecoms		
RIC (Ticker):	T.N		

Company Rating	LOW	MED.	HIGH
Risk	■		
Quality		■	
Valuation		■	

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Company Profile

Good 2012 Q2 results - EPS up 10% with higher wireless margins

- **Good Q2 results overall, with continued Wireline stabilization & Wireless growth. EPS growth was mostly due to increased Wireless margins to historically high levels (of 41%). In turn this was due to lower: cost of sales (ie. lower handset subsidies with fewer smartphone sales & lower network costs), headcount and depreciation. Key concerns are the declining revenue & subscriber growth, falling ARPU, and that since 2010 subscriber growth has been primarily from (lower-ARPU) pre-paid subs.**

- Q2 revenues excluding the Advertising Division rose modestly by +2%, to $31.3 bn.
  - Wireless revenue rose 5% to $16.4 bn, with 7% subscriber growth & 2% lower ARPU. Subscriber net adds of 1.2 m was driven by 0.9 m pre-paid net adds. Wireless data revenue growth appears to be stabilising at c. 20%, but voice is still contracting.
  - Wireline revenue fell by only $0.1 bn (-1%), to $14.9 bn; and continued to stabilise.
- Gross Margin rose 3.2% to 60.8%; with lower handset subsidies and network costs.
- EBITDA rose $0.5 bn (+5%), to $11.3 bn. EBITDA Margin rose 1.7% to 35.8%.
  - This was driven by higher Wireless margins (up 3.4% to 40.7%).
- EBIT rose $0.7 bn (+11%), to $6.8 bn. EBIT Margin rose 2.0% to 21.6%, with 2% lower depreciation. This also reflects the decline in CAPEX since 2010, to <15% of sales.
- Net Income rose $0.3 bn (+9%), to $3.9 bn, with a flat tax rate (at 34%).
- EPS rose +10% to $0.66, helped by 1% of its shares being repurchased.
- FCF rose $1.4 bn (+38%), to $5.2 bn, mostly due to $0.8 bn lower CAPEX.
- AT&T is on track to meet guidance for 2012 of "mid-single-digit" earnings growth.

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 sold 53% of Advertising Solutions and AT&T Interactive.

Investment thesis

AT&T is a utility with an attractive dividend yield (c. 5%) and a value stock investment profile. It has recurring revenues, strong cash flows & large wireless position in an oligopolistic market. AT&T's strategy is to stabilize its Wireline business while pushing Wireless growth & margins. Revenue growth is declining in this maturing market as subscriber growth and ARPUs fall. Since 2010, subscriber adds has been mostly low ARPU (pre-paid) subscribers, due to a weak competitive position relative to Verizon from an overloaded network & late LTE deployment. Fortunately there are signs that wireless competitive environment is easing with price increases. The high dividend pay-out ratios of over 70% restrict the capacity for dividend increases. **In summary, AT&T is doing moderately well but needs to regain its competitive position while also managing slowing growth and commoditisation of its lucrative voice revenues.**

SWOT analysis

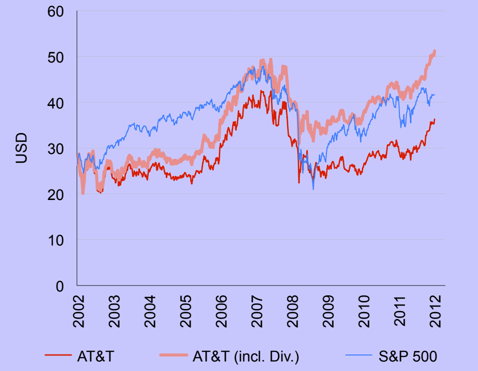
Strengths
- **Large size (economies of scale).**
- **#2 US wireless market position.**
- Strong free cash flow generation.
- High div. yield; but high pay-out ratio.

Weaknesses
- **Mature US telecoms market.**
- **Loosing ground to Verizon.**
- High smartphone subsidies.
- Lack of wireless spectrum.

Opportunities
- New data services eg. U-Verse & LTE.
- **Cost cutting from an all-IP network & headcount reductions.**
- Falling wireless CAPEX.

Threats
- Commoditisation of voice & data services; becoming a "dumb pipe".
- **Proposed spectrum purchase by Verizon from cable companies.**

Share Price - Last 10 Years



Fundamental Valuation	($ per share)		
(See Page 25)	**Bear**	**Base**	**Bull**
Valuation	31.3	**37.2**	43.9
Potential Return	-9%	**7%**	26%

Capital Structure	Per Share ($)	Total ($ Bn)
Share Price	**36.3**	
Number of Shares (bn)		5.9
Market Capitalization		213.5
Net Cash / (Debt)	-10.6	-62.4
Enterprise Value (EV)	46.9	275.6
Net Debt / Market Cap.		29%
Main Shareholder:		--

		Consensus Estimates	
Financial Results	**2011**	**2012e**	**2013e**
y/e 31 Dec	($ Bn)	($ Bn)	($ Bn)
Revenue	126.7	127.1	128.9
EBIT	9.2	24.6	25.7
Net income	3.9	14.1	14.9
Capital	105.5	99.7	103.7
Total Assets	270.3	284.1	288.2
Per Share Data	**2011**	**2012e**	**2013e**
EPS ($)	0.66	2.40	2.54
DPS ($)	1.73	1.77	1.81
Cash EPS ($)	2.44	2.03	2.24
BV Per Share ($)	17.74	16.97	17.65
Efficiency Analysis	**2011**	**2012e**	**2013e**
EBIT Margin	7.3 %	19.3 %	19.9 %
Net income Margin	3.1 %	11.1 %	11.6 %
Asset turnover	46.9 %	44.8 %	44.7 %
Net Gearing	256.2 %	284.9 %	277.8 %
ROE*	12.7 %	14.2 %	14.4 %
Net Gearing = Net Assets / Share Capital & Reserves			
Growth Analysis	**2011**	**2012e**	**2013e**
Revenue	1.9 %	0.3 %	1.4 %
EBIT	-53.0 %	>100%	4.4 %
Net income	-80.2 %	>100%	5.9 %
Valuation Ratios	**2011**	**2012e**	**2013e**
P / Sales	1.7	1.7	1.7
P / EBIT*	9.5	8.7	8.3
PE*	16.0	15.1	14.3
PEG*	--	2.2	2.4
P / BV	2.0	2.1	2.1
P / FCF	14.7	17.9	16.2
Dividend Yield	4.7 %	4.9 %	5.0 %
Pay-Out Ratio	261.0 %	73.7 %	71.2 %
Net Debt / EBITDA	1.5	1.2	1.1

Valuation Ratios are based on the current share price.
** = Excluding Unusual Items*

  Sources: AT&T, Indigo Equity Research

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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:

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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