

AT&T Inc.
Latest Results: 2012 Q3
 Country: USA
 Sector: Telecoms
 RIC (Ticker): T.N

Industry View: NEUTRAL
Company Rating: LOW MED. HIGH
 Risk
 Quality
 Valuation

N. Landell-Mills CFA
 Indigo Equity Research Limited
 www.indigo-equity-research.com

07 Nov 2012

Company Profile - In a tight corner

Medicore 2012 Q3 results - existing trends continue

Organic revenue growth was modest (+3%) and margins remain under pressure. Revenues continue to be driven by wireless & data, while fixed line & voice decline. The 3% EPS growth was low quality, being due to share repurchases & lower taxes.

Wireless revenue growth is stabilising at modest levels (5%); as the blended ARPU decline moderates & subscriber growth slows (albeit driven by resellers & devices). Post-paid wireless ARPU rose slightly (+2%) with better pricing and new data plans. AT&T is still losing ground to Verizon who takes most of the post-paid subscribers.

- Total Q3 organic revenue (excluding the Advertising disposal) rose 3%, to \$31.5 bn,
 - Wireless Service revenues rose 5%; with 5% subscriber growth and 1% lower ARPU.
 - Wireless Equipment revenue jumped 28%, with more upgrade fees & smartphone sales.
 - Wireline revenue continues its gradual decline, falling 2%; as the loss in numbers of lines slows and Business Solutions / Business Services & IP perform well.
- EBITDA fell -3%, to \$10.5 bn; & margins fell 1% to 34% due to weaker Wireless margins. **Overall, margins were weaker but remained within their normal historical range.**
- EBIT fell 3% to \$6.0 bn. EBIT Margin fell 0.6% to 19.2%; despite 2% lower depreciation (which reflects the decline in CAPEX since 2010, to <15% of sales).
- Pre Tax Profit fell \$0.1 bn (-3%), to \$5.4 bn.
- Net Income was flat at \$3.6 bn, helped by a lower tax rate (down 2%, to 32%).
- EPS rose \$0.02 (3%), to \$0.63, helped by 3% of its shares being repurchased.
- FCF rose \$1.4 bn (28%), to \$6.6 bn, mostly due to better working capital and other items.

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

Significant recent events

- AT&T plans to contribute \$9.5 bn in preferred equity to its pension fund.
- AT&T to acquire NextWave for \$650 m in cash.

Investment thesis - In a tight corner

AT&T is a utility with an attractive dividend yield (c. 5%) and a value stock investment profile. It has strong recurring revenues, cash flows & large wireless position in an oligopolistic market. AT&T has limited the decline in Wireline while maintaining modest Wireless growth & margins. In 2012, competitive pressures eased allowing for price increases, boosting post-paid ARPU.

Overall, AT&T is in a tight corner due to a maturing market and poor market positioning. Partly due to AT&T's late LTE deployment, Verizon is winning most new post-paid subscribers. As the industry's wireless subscriber growth slows, despite being the 2nd largest player, AT&T is having to compete with T-Mobile & Sprint for the low ARPU (pre-paid & reseller) subscribers. In addition, its high pay-out ratios (>70%) restrict the capacity for future dividend increases.

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.

Opportunities

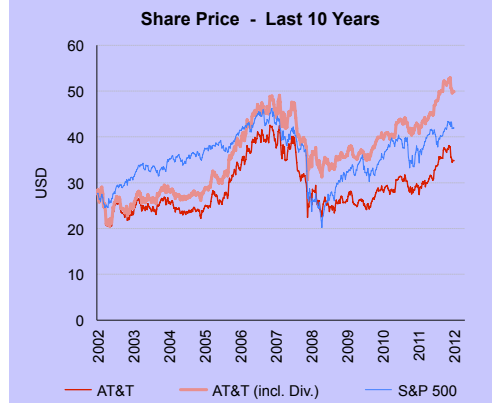
- New data services eg. U-Verse & LTE.
- Cost cutting from an all-IP network & headcount reductions.
- Falling wireless CAPEX.

Weaknesses

- Mature US telecoms market.
- Under-funded pension.
- Lack of LTE coverage.
- Lack of wireless spectrum.

Threats

- Commoditisation of voice & data services; becoming a "dumb pipe".
- Verizon is increasing its lead in wireless post-paid subscribers.



Fundamental Valuation	(\$ per share)		
	Bear	Base	Bull
Valuation	30.9	35.6	40.9
Potential Return	-6%	8%	23%

Capital Structure	Per Share	Total
	(\$)	(\$ Bn)
Share Price	34.8	
Number of Shares (bn)		5.8
Market Capitalization		201.7
Net Cash / (Debt)	-10.6	-61.5
Enterprise Value (EV)	45.4	262.9
Net Debt / Market Cap.		31%
Main Shareholder:		--

Financial Results	Consensus Estimates		
	2011	2012e	2013e
y/e 31 Dec	(\$ Bn)	(\$ Bn)	(\$ Bn)
Revenue	126.7	127.1	128.5
EBIT	9.2	24.4	25.7
Net Income	3.9	14.0	15.0
Capital	105.5	99.7	103.8
Total Assets	270.3	264.3	268.4

Per Share Data	2011			2012e			2013e		
		(\$)			(\$)			(\$)	
EPS		0.66		2.42		2.60			
DPS		1.73		1.77		1.81			
Cash EPS		2.44		2.77		2.29			
BV Per Share		17.74		17.22		17.92			

Efficiency Analysis	2011			2012e			2013e		
		%			%			%	
EBIT Margin		7.3 %		19.2 %		20.0 %			
Net Income Margin		3.1 %		11.0 %		11.7 %			
Asset Turnover		46.9 %		48.1 %		47.9 %			
Net Gearing		256.2 %		265.0 %		258.7 %			
ROE*		12.7 %		14.1 %		14.5 %			

Growth Analysis			
	2011	2012e	2013e
Revenue	1.9 %	0.3 %	1.1 %
EBIT	-53.0 %	>100%	5.6 %
Net Income	-80.2 %	>100%	7.1 %

Valuation Ratios	2011			2012e			2013e		
P / Sales		1.6		1.6		1.6			
EV / EBITDA		6.4		6.2		6.0			
PE*		15.1		14.4		13.4			
PEG*		--		1.8		1.9			
P / BV		1.9		2.0		1.9			
P / FCF		13.9		12.6		15.2			
Dividend Yield		5.0 %		5.1 %		5.2 %			
Pay-Out Ratio		261.0 %		73.0 %		69.7 %			
Net Debt / EBITDA		1.5		1.7		1.6			

Valuation Ratios are based on the current share price.

* = Excluding Unusual Items