AT&T

AT&T Inc.		**Industry View:**	**NEUTRAL**
Latest Results:	2012 Q4	**Company Rating:**	LOW / MED. / HIGH
Country:	USA	Risk	LOW
Sector:	Telecoms	Quality	MED.
RIC (Ticker):	T.N	Valuation	MED.

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Overview - 2012 Q4 Results

Poor 2012 Q4 results - margins fall & large pension charge

The existing well-entrenched trends continue: low revenue growth, restricted by wireline which is in gradual decline despite progress with U-Verse; slowing wireless subscriber growth as the market matures, and flat overall (blended) wireless ARPU. Verizon Wireless continues to outperform AT&T, taking most of the post-paid adds. AT&T's wireless margins are under pressure, but it has maintained wireline margins. Worryingly, AT&T took a large $10 bn charge to cover a hole in its pension fund.

- **Q4 Revenue rose $0.9 bn (3%), to $32.6 bn (excluding the Advertising disposal).**
  - Wireless Revenue rose 6% ($0.9 bn), with 4% more subscribers, flat blended ARPU and equipment growth of 15% ($0.3 bn) from upgrade fees & smartphone sales.
  - **Net subscribers adds were about half that of the previous year; although this was a relatively good Q for post-paid adds (of 0.8m, up 8%) driven by tablets.**
  - Wireline continues its gradual revenue decline (-0.5%); but consumer growth improved.
- Q4 EBIT* fell -8%, to $4.0 bn. EBIT* Margin fell sharply QoQ (by 7%) and was down 1% YoY (to a margin of 12%), which is at the bottom end of their normal historical range.
  - **Margins were hit by seasonally high smartphone subsidies; which is the downside to more post-paid net adds. Margins are expected to rebound in Q1.**
- Q4 Pre-Tax Profit* fell $88 m (-2%), to $3.4 bn. PTP* Margin fell 0.6% to 10.6%.
- **Net Income* fell $43 m (-2%), to $2.4 bn.**
- **The underlying EPS* rose +3%, to $0.42; boosted by net 5% share repurchases.**
- GAAP EPS was -$0.68; including the large pension charge of $1.10 per share.
- ** = Excludes Unusual Items   Analysis this Q is complicated by the large number of Unusual Items in Q4 2012 and Q4 2011; eg. We did not treat losses due to Super Storm Sandy as an unusual event.*

Note: Growth rates are stated on a year-on-year basis.

Significant recent events

- AT&T to acquire Altel (Atlantic Tele-Network) wireless operations for $780 m.
- AT&T to buy $1.9 bn in wireless spectrum from Verizon Wireless.

Investment thesis - In a tight corner; low growth & margin pressure

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 and is the 2nd largest wireless operator in the US. AT&T has maintained modest Wireless growth & margins while limiting the decline in Wireline.

Since 2010 the wireless competitive environment changed as AT&T deployed LTE late, failed to obtain sufficient spectrum and its previous strategy to grow via acquisitions was blocked. **Now, AT&T is in a tight corner due to a maturing market and poor competitive positioning.** As the wireless industry's subscriber growth slows, Verizon takes the best quality (post-paid) subscribers; leaving AT&T to compete with T-Mobile & Sprint for the low ARPU 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.

Weaknesses

- **Mature US telecoms market.**
- Commoditisation of services.
- Lack of LTE coverage.
- Lack of wireless spectrum.

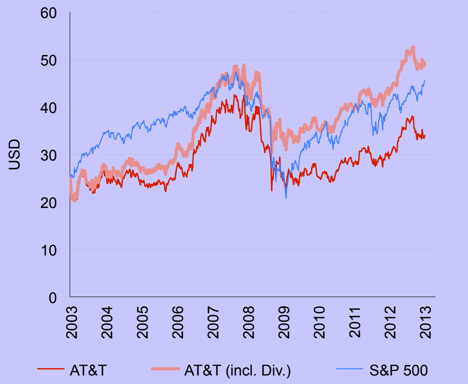
Opportunities

- New data services eg. U-Verse & LTE.
- Project Velocity IP
- Wireless spectrum purchases.
- Share repurchases.

Threats

- Increase competition from Sprint.
- Increasing CAPEX.
- **Verizon is increasing its lead in wireless post-paid subscribers.**

Share Price - Last 10 Years



Fundamental Valuation			*($ per share)*
(See Page 10)	**Bear**	**Base**	**Bull**
Valuation	30.1	**34.5**	39.4
Potential Return §	-12%	**1%**	16%

Capital Structure	Per Share ($)	Total ($ Bn)
Share Price	**34.0**	
Number of Shares (bn)		5.7
Market Capitalization		192.6
Net Cash / (Debt)	-11.5	-65.0
Enterprise Value (EV)	45.4	257.2
Net Debt / Market Cap.		34%
Main Shareholder:		--

Consensus Estimates

Financial Results	**2012**	**2013e**	**2014e**
y/e 31 Dec	($ Bn)	($ Bn)	($ Bn)
Revenue	127.4	128.8	131.0
EBIT*	23.0	24.5	25.2
Net Income*	13.5	14.3	14.9
Capital	92.4	77.1	68.9
Total Assets	272.3	255.1	247.1
FCF	19.7	13.0	13.6
EPS	1.25	2.53	2.64
DPS	1.77	1.81	1.86
BV Per Share	15.87	13.62	12.17

Efficiency Analysis	**2012**	**2013e**	**2014e**
EBIT Margin*	18.0 %	19.0 %	19.2 %
Net Income Margin*	10.6 %	11.1 %	11.4 %
Asset Turnover	46.8 %	50.5 %	53.0 %
Net Gearing	294.8 %	330.9 %	358.7 %
ROE*	14.6 %	18.6 %	21.7 %

Net Gearing = Net Assets / Share Capital & Reserves

Growth Analysis	**2012**	**2013e**	**2014e**
Revenue	0.6 %	1.1 %	1.7 %
EBIT*	1.8 %	6.6 %	2.7 %
Net Income*	3.5 %	6.2 %	4.2 %

Valuation Ratios	**2012**	**2013e**	**2014e**
P / Sales	1.5	1.5	1.5
EV / EBITDA	6.3	6.0	5.8
P / EBIT*	8.4	7.9	7.7
PE*	14.3	13.4	12.9
PEG*	2.5	1.5	3.1
P / BV	2.1	2.5	2.8
P / FCF	9.8	14.8	14.2
Dividend Yield	5.3 %	5.3 %	5.5 %
Pay-Out Ratio	141.8 %	71.5 %	70.5 %
Net Debt / EBITDA	1.6	2.0	2.2

Valuation Ratios are based on the current share price.

** = Excluding Unusual Items   § = includes div.*

AT&T

INDIGO EQUITY RESEARCH

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Explanations

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 = The risk of earnings disappointment & volatility as well as the risk of a change in the valuation ratios that impact the company's share price. This depends on items such as revenue growth, profit margin volatility, investor sentiment towards the company etc..... But this does not include the market risk of these elements changing.

Quality = The quality of the company reflects its ability to maintain or increase earnings from its competitive advantages, strategy, brand, management, market position, pricing power, services etc.....

Valuation = This is an 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; but are nonetheless subjective and dependent on the analyst's individual opinion & analysis of the company.

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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