AT&T

AT&T Inc.		**Industry View:**		**NEUTRAL**
Latest Results:	**Q1 2013**	**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 - Running out of options

Poor Q1 2013 Results - Slowing revenues and weak margins

Organic revenues rose 1%; adjusted EPS was up 8.5% on the back of lower taxes & large share repurchases. AT&T maintained its FY guidance for >2% revenue growth. Key issues remain slowing wireless revenue growth and declining wireline revenues. In turn, Wireless growth is slowing with slowing subscriber growth and flat ARPUs. Data growth potential is diminishing as c. 72% of all post-paid subscribers now have smartphones and Wireline data growth from U-Verse / broadband is slowing rapidly. In addition, its margins are weakening, despite telecoms becoming less competitive. In short, AT&T is running out of options to maintain EPS growth and fund dividends. AT&T Wireless continues to significantly underperform Verizon Wireless in terms of revenue growth, post-paid net subscriber adds, ARPU growth and EBIT margins.

- **Q1 Revenue fell $0.5 bn (-1.5%) to $31.4 bn.**
  - Organic revenues (excluding the disposed Advertising Solutions) rose 1% to $31.4 bn.
  - Q1 revenue growth of -1.5%, was driven by Wireless (3.4%), Wireline (-1.8%).
- **EBIT fell 3% to $5.9 bn. Margin was flat at 18.9%; but rebounded QoQ from a weak Q4.**
  - Wireless EBIT margin rose 0.7% to 27.9%, Wireline EBIT margin fell 1.1% to 11.1%.
  - Adjusted EBIT (excluding Advertising Solutions) fell 1%.
- **Pre Tax Profit fell 3% to $5.3 bn. Margin fell 0.3% to 17.0%.**
- **Net Income rose 3% to $3.7 bn, helped by a lower tax rate (down 4.6%, to 29.2%).**
  - AT&T benefitted from a tax settlement worth $0.03 per share.
- **Q1 GAAP EPS rose 11% to $0.67, boosted by 7% share repurchases.**
- **Adjusted for tax benefits and the sale of Advertising Solutions, EPS was up 8.5%.**

Comparisons (e.g. margins changes & growth rates) are stated on a Year-on-Year (YoY) basis.

Significant recent events

- Dish bids $25.5 bn for Sprint; starting a takeover battle with SoftBank.
- AT&T hints at asset sales to fund dividends and share repurchases.

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. Overall, AT&T maintains modest Wireless growth & margins while Wireline gradually declines. **Since 2010 AT&T has been in an increasing tight corner due to a maturing market, poor competitive positioning and its strategy to grow via large acquisitions was blocked.** Despite the wireless market becoming less competitive AT&T Wireless struggles with a lack of spectrum, deploying LTE late and Verizon taking the best quality (post-paid) subscribers. AT&T Wireline also faces increasingly strong competition from cable in the broadband market. High pay-out ratios (>70%) and weak growth restrict AT&T's capacity for dividend increases. The expected acquisition of Sprint by Softbank or Dish will increase the competition it faces.

SWOT analysis - Key current drivers & catalysts

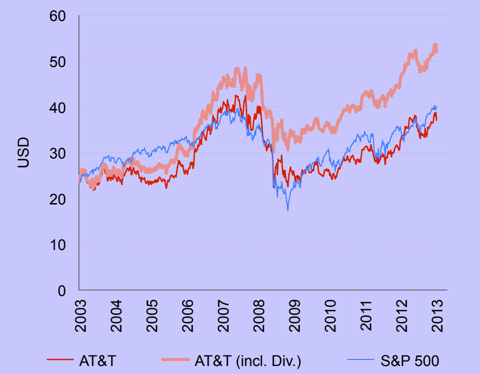
Strengths
- **Large size (economies of scale).**
- **#2 US wireless market position.**
- High div. yield; but high pay-out ratio.

Weaknesses
- **Mature US telecoms market.**
- Limited post-paid subscriber growth.
- Outperformed by Verizon Wireless.

Opportunities
- New data services eg. U-Verse & LTE.
- Project Velocity IP
- Share repurchases.

Threats
- Increase competition from Sprint.
- Margin pressure.
- Cable is taking most broadband adds.

Share Price - Last 10 Years



Fundamental Valuation			*($ per share)*
(See Page 31)	**Bear**	**Base**	**Bull**
Valuation	30.4	**35.0**	40.1
Return (incl. Div.)	-18%	**-6%**	8%

Capital Structure	Per Share ($)	Total ($ Bn)
Share Price	**37.0**	
Number of Shares (bn)		5.5
Market Capitalization		204.8
Net Cash / (Debt)	-12.7	-70.3
Enterprise Value (EV)	49.7	274.7
Net Debt / Market Cap.		34%
Main Shareholder:		--

Consensus Estimates

Financial Results		**2012**	**2013e**	**2014e**
y/e 31 Dec		($ Bn)	($ Bn)	($ Bn)
Revenue		127.4	128.4	130.6
EBIT*		23.0	23.7	25.1
Net Income*		13.5	14.0	14.8
Capital		92.4	90.3	94.8
Total Assets		272.3	270.2	274.9
FCF		19.7	13.3	13.4
EPS	($)	1.25	2.54	2.67
DPS	($)	1.77	1.81	1.86
BV Per Share	($)	15.87	16.32	17.14

Efficiency Analysis	**2012**	**2013e**	**2014e**
EBIT Margin*	18.0 %	18.5 %	19.2 %
Net Income Margin*	10.6 %	10.9 %	11.3 %
Asset Turnover	46.8 %	47.5 %	47.5 %
Net Gearing	294.8 %	299.4 %	290.0 %
ROE*	14.6 %	15.5 %	15.6 %

Net Gearing = Net Assets / Share Capital & Reserves

Growth Analysis	**2012**	**2013e**	**2014e**
Revenue	0.6 %	0.8 %	1.7 %
EBIT*	1.8 %	3.3 %	5.9 %
Net Income*	3.5 %	4.0 %	5.4 %

Valuation Ratios	**2012**	**2013e**	**2014e**
P / Sales	1.6	1.6	1.6
EV / EBITDA	6.7	6.5	6.3
P / EBIT*	8.9	8.6	8.2
PE*	15.2	14.6	13.9
PEG*	2.6	1.5	2.6
P / BV	2.2	2.3	2.2
P / FCF	10.4	15.4	15.2
Dividend Yield	5.0 %	5.0 %	5.0 %
Pay-Out Ratio	141.8 %	71.4 %	69.6 %
Net Debt / EBITDA	1.6	1.7	1.5

Valuation Ratios are based on the current share price.

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

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 = 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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