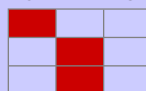


AT&T Inc.  
**Latest Results:** Q2 2013  
 Country: USA  
 Sector: Telecoms  
 RIC (Ticker): T.N

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



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## Company Profile - Lack of underlying EPS growth

### Weak Q2 2013 Results - Weak margins & EPS, but ARPU increases

Q2 Revenue rose 2%; EBIT fell 10% and EBIT Margin fell 2.5%. Net Income\* fell 8%. GAAP EPS growth of +7%, was mostly from: 8% of shares being repurchased and a \$0.04 gain on sale of shares in América Móvil. In summary, AT&T lacks underlying earnings growth due to persistent low revenue growth and margin pressure.

Wireless continues to drive earnings as Wireline contracts. A key development this Q was a small increase in wireless ARPU, which offset lower subscriber growth. AT&T's value hinges on ARPU growth to boost revenues & margins (and thus EPS). In turn, this is driven by demand for higher speed (4G) wireless data services, as AT&T upgrades its network; as well as a shift to usage based pricing & more connected devices. But ARPU growth from data services looks unlikely as AT&T's data revenues are shrinking. Verizon Wireless continues to outperform AT&T, with much stronger revenue growth and rising margins, from better growth in Post-Paid subscribers and ARPU.

- Q2 revenue rose \$0.5 bn (+2%) to \$32.1 bn.
  - Revenues were driven by: Wireless +\$0.9 bn (+6%) and Wireline -\$0.1 bn (-1%).
  - Wireless was driven by Service Revenues up \$0.6 bn or 4%; (in turn due to 3% more subscribers and 1% higher ARPU); and Equipment Revenue up \$0.3 bn (+21%).
- EBIT fell \$0.7 bn (-10%) to \$6.1 bn. EBIT Margin fell 2.5% to 19.1%.
- Net Income\* fell 8% to \$3.6 bn. EPS\* rose c. 1% to \$0.67, with c. 8% share repurchases.
- Q2 GAAP EPS rose \$0.04 (+7%) to \$0.71, including a \$0.04 gain on América Móvil.
- FCF fell \$1.1 bn (-21%) to \$4.1 bn; due to higher CAPEX and working capital.

\* = Excluding Unusual Items - América Móvil this Q; also excludes prior year Unusual Items.  
 Comparisons (e.g. margins changes & growth rates) are stated on a Year-on-Year (YoY) basis.

### Significant recent events

- AT&T is to buy Leap Wireless to accelerate entry into the prepaid segment.
- AT&T reported to be looking for wireless acquisitions in Europe.

### 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 its No. 2 position in an oligopolistic US wireless market; AT&T struggles with a lack of spectrum, deploying LTE late and Verizon taking the best quality (post-paid) subscribers. AT&T Wireline faces strong competition from cable in the broadband market; particularly as it lacks content offerings. Also, Softbank's acquisition of Sprint will increase wireless competition. High pay-out ratios (>70%) and weak growth restrict AT&T's capacity for dividend increases.

### SWOT analysis - Key current drivers & catalysts

#### Strengths

- Large size (economies of scale).
- #2 in an oligopolistic US wireless market.
- High div. yield; but high pay-out ratio.

#### Opportunities

- Shift to usage based pricing.
- Project Velocity IP, network upgrades.
- Wireless prepaid segment?

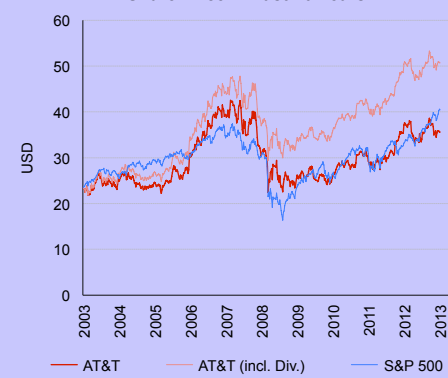
#### Weaknesses

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

#### Threats

- Increased competition from Sprint.
- Margin pressure.
- Cable taking most broadband adds.

Share Price - Last 10 Years



### Fundamental Valuation (See Page 31)

(12 month outlook)	Bear	Base	Bull
Forecast Share Price	\$31.0	\$33.8	\$40.7
Return (incl. Div.)	-13%	0%	14%

### Capital Structure

	Per Share (\$)	Total (\$ Bn)
<b>Current Share Price</b>	<b>\$35.6</b>	
Number of Shares (bn)		5.4
Market Capitalization		192.1
Net Cash / (Debt)	-13.1	-70.6
Enterprise Value (EV)	48.6	262.4
Net Debt / Market Cap.		37%
Main Shareholder:		--

### Consensus Estimates

Financial Results	2012	2013e	2014e
y/e 31 Dec	(\$ Bn)	(\$ Bn)	(\$ Bn)
Revenue	127.4	128.3	130.8
EBIT*	23.0	23.3	25.0
Net Income*	13.5	13.5	14.5
Capital	92.4	86.7	90.9
Total Assets	272.3	266.7	271.1
FCF	19.7	13.2	13.2
EPS (\$)	1.25	2.53	2.73
DPS (\$)	1.77	1.81	1.86
BV Per Share (\$)	15.87	16.04	17.12

Efficiency Analysis	2012	2013e	2014e
EBIT Margin*	18.0 %	18.1 %	19.1 %
Net Income Margin*	10.6 %	10.5 %	11.1 %
Asset Turnover	46.8 %	48.1 %	48.2 %
Net Gearing	294.8 %	307.8 %	298.3 %
ROE*	14.6 %	15.5 %	15.9 %

Net Gearing = Net Assets / Share Capital & Reserves

Growth Analysis	2012	2013e	2014e
Revenue	0.6 %	0.7 %	1.9 %
EBIT*	1.8 %	1.2 %	7.3 %
Net Income*	3.5 %	-0.3 %	7.7 %

Valuation Ratios	2012	2013e	2014e
P / Sales	1.5	1.5	1.5
EV / EBITDA	6.4	6.3	6.0
P / EBIT*	8.4	8.3	7.7
PE*	14.2	14.3	13.3
PEG*	2.5	1.9	1.4
P / BV	2.1	2.2	2.1
P / FCF	9.7	14.5	14.6
Dividend Yield	5.3 %	5.3 %	5.3 %
Pay-Out Ratio	141.8 %	71.5 %	68.1 %
Net Debt / EBITDA	1.6	1.8	1.6

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

**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.

### Company Rating:

	LOW	MED.	HIGH
Risk			
Quality			
Valuation			

**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 is a highly subjective assessment made by the analyst on a case-by-case basis.

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