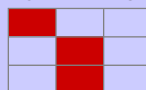


AT&T Inc.
Latest Results: Q3 2013
 Country: USA
 Sector: Telecoms
 RIC (Ticker): T.N

Fundamental Valuation: \$33.0
Indigo View: Downside risk
Industry View: NEUTRAL
Company Rating: LOW MED. HIGH
 Risk
 Quality
 Valuation



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28 Oct 2013

Company Profile - Weak fundamentals

Mixed Q3 2013 Results - Share repurchases drive EPS growth

Q3 Revenue grew 2.2%. EBIT* Margin fell 0.7% to 18.5%. EPS* rose 9.2% to \$0.69. The fundamentals remain weak. Excluding a \$0.2 bn gain on transfer of spectrum; pre-tax profit fell 3%. EPS growth was from share repurchases and a lower tax rate. Wireless continues to drive revenues. In turn, wireless growth is increasingly from tablets (connected devices), while ARPU and post-paid subscriber growth has remained subdued. EBIT margins fell with a decline in wireline margins.

In summary, AT&T continues to perform badly compared to Verizon, struggling to compete on network quality or customer service. Meanwhile, AT&T faces increasing competition from T-Mobile & Sprint; fighting for the low-end customers & tablets. Of concern this Q is deteriorating FCF due to rising CAPEX; on-going pension deficit and the cell tower sale to generate cash (indicating potential funding concerns).

- Q3 Revenue rose \$0.7 bn (+2.2%) to \$32.2 bn.
 - Revenues were driven by: Wireless up \$0.8 bn (+5%), while Wireline fell \$0.1 bn (-1%).
 - Wireless revenue growth was driven by 3% more subscribers and 1% higher ARPU.
 - About 1/3 of the 1.6m wireless subscriber net adds this Q was from acquisitions.
 - 1.0 m organic subscriber net adds was driven primarily by 0.8m Devices (eg. tablets).
- EBIT* fell \$80 m (-1.3%) to \$6.0 bn. EBIT* Margin fell 0.7% to 18.5%.
- Net Income* rose \$18 m (+0.5%) to \$3.7 bn, helped by a tax rate* down 3%, to 29%.
- Q3 EPS* rose 9.2% to \$0.69; boosted 8% by share repurchases. GAAP EPS rose 14%.

* Excluding Unusual Items (\$0.2 bn gain this Q)

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

Significant recent events

- AT&T agrees sale & leaseback for a portfolio of its cell towers to Crown Castle for c. \$4.9 bn.
- AT&T is to acquire Leap Wireless for c. \$1.2 bn in cash (plus \$2.8 bn in net debt).

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. Overall, AT&T maintains modest Wireless growth & margins while Wireline gradually declines. Wireless growth is being driven by increasing data usage with the shift to smartphones & tablets. 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

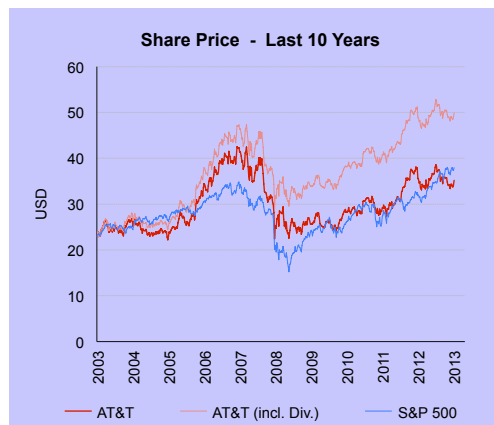
- Shift to usage based pricing.
- Project Velocity IP, network upgrades.
- Wireless prepaid segment?

Weaknesses

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

Threats

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



Fundamental Valuation (See Page 33)

(12 month outlook)	Bear	Base	Bull
Forecast Share Price	\$28.6	\$33.0	\$37.9
Return (incl. Div.)	-13%	-1%	13%

Capital Structure

	Per Share (\$)	Total (\$ Bn)
Current Share Price	\$35.2	
Number of Shares (bn)		5.3
Market Capitalization		187.6
Net Cash / (Debt)	-14.0	-74.9
Enterprise Value (EV)	49.2	262.0
Main Shareholder:		--

Consensus Estimates

Financial Results	2012	2013e	2014e
y/e 31 Dec	(\$ Bn)	(\$ Bn)	(\$ Bn)
Revenue	127.4	128.6	131.1
EBIT*	23.0	22.6	24.2
Net Income*	13.5	13.4	14.0
Share Capital	92.4	84.9	88.7
Total Assets	272.3	265.1	269.1
FCF	19.7	15.0	12.7
EPS*	(\$)	2.32	2.49
DPS	(\$)	1.77	1.81
BV per share	(\$)	15.87	15.71

Efficiency Analysis	2012	2013e	2014e
EBIT* Margin	18.0 %	17.6 %	18.4 %
Net Income* Margin	10.6 %	10.5 %	10.7 %
Asset Turnover	47 %	49 %	49 %
Total Assets / Equity	295 %	312 %	304 %
ROE*	14.6 %	15.8 %	15.8 %

Growth Analysis	2012	2013e	2014e
Revenue	0.6 %	0.9 %	1.9 %
EBIT*	1.8 %	-1.6 %	6.8 %
Net Income*	3.5 %	-0.3 %	4.3 %
EPS*	5.8 %	7.4 %	6.2 %

Valuation Ratios	2012	2013e	2014e
P / Sales	1.5	1.5	1.4
EV / EBITDA	6.4	6.3	6.1
P / EBIT*	8.2	8.3	7.8
PE*	15.2	14.1	13.3
PEG*	2.6	1.9	2.2
P / BV	2.2	2.2	2.1
P / FCF	9.5	12.5	14.8
Dividend Yield	5.0 %	5.1 %	5.3 %
Pay-Out Ratio	141.8 %	70.8 %	70.0 %
Net Debt / EBITDA	1.6	1.8	1.7

Valuation Ratios are based on the current share price.

* = Excluding Unusual Items

Explanations and Definitions

Brief business description - AT&T

AT&T is one of 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

EBITDA = Earnings Before Interest, Tax, Depreciation & Amortisation

TTM = Trailing 12 Months

Last 12m = 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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