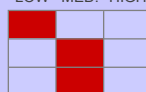


AT&T Inc.  
**Latest Results:** Q1 2014  
 Country: USA  
 Sector: Telecoms  
 RIC (Ticker): T.N

**Fundamental Valuation:** \$28.0  
**Indigo View:** Downside Risk  
**Industry View:** Unattractive  
**Company Rating:** LOW MED. HIGH  
 Risk  
 Quality  
 Valuation



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## Company Profile - Downside risk

### Mediocre Q1 2014 Results - Small margin improvement

Q1 revenue grew 3.6%; But we estimate organic growth was c. 2% - flat from last Q. EBIT grew 6%, as margin rose 0.4% to 19.3%. GAAP EPS rose only 4% to \$0.70; due to a tax rate up 5%, to 34%; albeit boosted 5% by share repurchases.

**In short, renewed post-paid wireless growth momentum continues to drive results.** Excluding acquisitions, revenue growth was driven by Wireless, while Wireline fell slightly. In turn, wireless was driven mainly by a renewed growth momentum increasing Post-Paid subscribers & ARPU (via new marketing plans such as AT&T Next & Mobile Share Value). The Leap acquisition boosted post-paid adds, which in turn dragged total ARPU down 2%. Group EBIT growth of 6% was driven by Wireless (+8%) with a 0.4% higher margin (due to cost savings and lower handset subsidies); despite Wireline's EBIT margin falling 1.1%.

A key concern is that AT&T is selling assets to generate cash (eg. Móvil shares, cell towers, real estate, ...) while FCF shrinks. FCF fell \$0.9 bn (-22%) to \$3.1 bn this Q.

**Our low fundamental valuation is based on the expectation that EPS will be hit by the increasing wireless industry price war & competition from Sprint & T-Mobile, and weaker US economic growth. In turn this will trigger lower valuation multiples. The potential industry restructuring with Comcast & TWC; Sprint & T-Mobile; and AT&T & Dish mergers remain wild cards that may impact the competitive landscape.** In addition, we believe that equity markets are significantly overvalued, due to low interest rates and QE (money printing); making a significant market correction in 2014 very likely.

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

### Significant recent events

- AT&T reported to be nearing a c. \$50bn bid for DirecTV.
- US wireless industry price war deepens.

### 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. Wireless competition is increasing from re-vitalized Sprint & T-Mobile. High pay-out ratios (>70%) and weak revenue growth restrict AT&T's capacity to raise dividends.

### 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.
- Connected homes & cars?

#### Weaknesses

- Mature US telecoms market.
- Becoming a "dumb pipe".
- Outperformed by Verizon Wireless.

#### Threats

- Wireless margin pressure due to increased wireless & price war.
- Cable taking most broadband adds.



### Fundamental Valuation (See Page 33)

(12 month outlook)	Bear	Base	Bull
Forecast Share Price	\$24.0	\$28.0	\$32.4
Return (incl. Div.)	-29%	-18%	-5%

### Capital Structure

	Per Share (\$)	Total (\$ Bn)
<b>Current Share Price</b>	<b>\$36.2</b>	
Number of Shares (bn)		5.2
Market Capitalization		189.6
Net Cash / (Debt)	-14.6	-76.3
Enterprise Value (EV)	50.7	265.4
Main Shareholder:		--

	2013	2014e	2015e
Revenue	128.8	133.5	135.8
EBIT*	23.2	24.4	25.4
Net Income*	13.8	14.1	14.8
Share Capital	91.0	94.2	99.4
Total Assets	277.8	281.8	287.3
FCF	13.9	12.3	12.1
EPS*	2.55	2.70	2.84
DPS	1.80	1.85	1.88
BV per share	16.90	18.00	19.07

### Consensus Estimates

	2013	2014e	2015e
EBIT* Margin	18.0 %	18.3 %	18.7 %
Net Income* Margin	10.7 %	10.6 %	10.9 %
Asset Turnover	46 %	47 %	47 %
Total Assets / Equity	305 %	299 %	289 %
ROE*	15.1 %	15.0 %	14.9 %

	2013	2014e	2015e
Revenue	1.0 %	3.7 %	1.7 %
EBIT*	0.8 %	5.2 %	4.1 %
Net Income*	1.9 %	2.8 %	4.7 %
EPS*	10.2 %	5.7 %	5.2 %

	2013	2014e	2015e
P / Sales	1.5	1.4	1.4
EV / EBITDA	6.4	6.1	6.0
P / EBIT*	8.2	7.8	7.5
PE*	14.2	13.4	12.7
PEG*	1.4	2.3	2.5
P / BV	2.1	2.0	1.9
P / FCF	13.7	15.5	15.6
Dividend Yield	5.0 %	5.1 %	5.2 %
Pay-Out Ratio	53.1 %	68.5 %	66.2 %
Net Debt / EBITDA	1.7	1.6	1.5

### Valuation Ratios

	2013	2014e	2015e
Revenue	1.0 %	3.7 %	1.7 %
EBIT*	0.8 %	5.2 %	4.1 %
Net Income*	1.9 %	2.8 %	4.7 %
EPS*	10.2 %	5.7 %	5.2 %

*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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