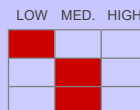


AT&T Inc.
 Latest Results: Q4 2014
 Country: USA
 Sector: Telecoms
 RIC (Ticker): T.N

Fundamental Valuation: --
Indigo View: --
Industry View: **Unattractive**
Company Rating: LOW MED. HIGH
 Risk
 Quality
 Valuation



N. Landell-Mills CFA
 Indigo Equity Research Limited
 www.indigo-equity-research.com

13 Feb 2015

Snapshot of Q4 2014 - Telecoms price war deepens

Weak Q4 2014 Results - Margins deteriorate further

Indigo's more detailed independent, buy-side, fundamental equity research reports (c. 20 pages) can be purchased via subscription or a pay-per-view basis, from the Indigo website: www.indigo-equity-research.com

Significant recent events

- AT&T makes \$6.8 bn post-tax non-cash losses charges in Q4; mostly for pensions.
- AT&T spent a massive \$18 bn in wireless spectrum auctions, which will hit its gearing.

Investment thesis - In a tight corner

AT&T is a utility with an attractive dividend yield (c. 5%) and value stock investment profile. But high pay-out ratios (>70%) and weak EPS growth restrict its capacity to raise dividends. Overall, Wireless has driven revenue growth & margins while Wireline gradually declines. Despite its No. 2 position in the wireless market; AT&T struggles to compete with Verizon. Wireless growth is driven by the shift to smartphones, tablets, cars and internet of things.

AT&T's growth & margins are under rising pressure due to a maturing telecoms market, wireless price competition from Sprint & T-Mobile, and wireline competition from cable. AT&T is repositioning strategically, by acquiring DirectTV & Mexican wireless companies (Lusacell & Nextel); and selling various assets (eg. wireless towers, wireline operations). Even with the DIRECTV merger, AT&T will still lack a sufficient competitive edge & scale in video & broadband; especially if the Comcast & TWC merger completes.

SWOT analysis

Strengths

- #2 in an oligopolistic US wireless market.
- Focus on post-paid wireless subscribers.
- High div. yield; but high pay-out ratio.

Weaknesses

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

Opportunities

- Shift to usage based plans?
- DIRECTV & Mexican acquisitions?
- Connected homes & cars?

Threats

- Increased gearing.
- Comcast & TWC merger.
- Cable taking most broadband adds.



Fundamental Valuation

	Bear	Base	Bull
Forecast Share Price	See the full report		
Return (incl. Div.)			
Capital Structure	Per Share	Total	
	(\$)	(\$ Bn)	
Current Share Price	\$34.9		
Number of Shares (bn)			5.2
Market Capitalization			181.2
Net Cash / (Debt)		-14.1	-73.5
Enterprise Value (EV)		48.9	254.1
Main Shareholder:			--

Consensus Estimates

Financial Results	2014	2015e	2016e
y/e 31 Dec	(\$ Bn)	(\$ Bn)	(\$ Bn)
Revenue	132.4	134.9	137.0
EBIT*	13.9	23.5	24.1
Net Income*	8.3	14.3	14.2
Share Capital	86.4	91.1	95.7
Total Assets	292.8	295.8	300.7
FCF	10.1	11.3	11.1
EPS*	(\$)	1.60	2.80
DPS	(\$)	1.84	1.87
BV per share	(\$)	16.54	17.77

Efficiency Analysis	2014	2015e	2016e
EBIT* Margin	10.5 %	17.4 %	17.6 %
Net Income* Margin	6.3 %	10.6 %	10.4 %
Asset Turnover	45 %	46 %	46 %
Total Assets / Equity	339 %	325 %	314 %
ROE*	9.7 %	15.7 %	14.8 %

Growth Analysis	2014	2015e	2016e
Revenue	2.9 %	1.9 %	1.5 %
EBIT*	-40.1 %	69.3 %	2.7 %
Net Income*	-39.3 %	71.8 %	-1.0 %
EPS*	-37.4 %	75.0 %	0.5 %

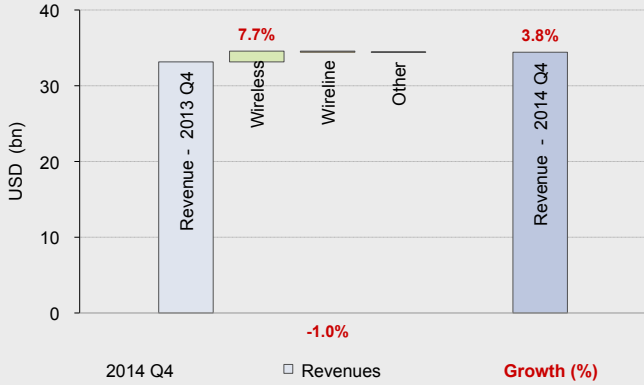
Valuation Ratios	2014	2015e	2016e
P / Sales	1.4	1.3	1.3
EV / EBITDA	7.9	6.1	6.0
P / EBIT*	13.1	7.7	7.5
PE*	21.8	12.5	12.4
PEG*	--	0.2	>10
P / BV	2.1	2.0	1.8
P / FCF	17.9	16.0	16.3
Dividend Yield	5.3 %	5.4 %	5.5 %
Pay-Out Ratio	154.3 %	66.9 %	67.6 %
Net Debt / EBITDA	2.3	1.8	1.7

Valuation Ratios are based on the current share price.

* = Excluding Unusual Items

Q4 2014 Results - Changes In Revenue Since Last Year (YoY)

YoY Change in Revenue by Division



** = Estimated Growth excluding major M&A activities.

Revenues by Division - Q4 2014

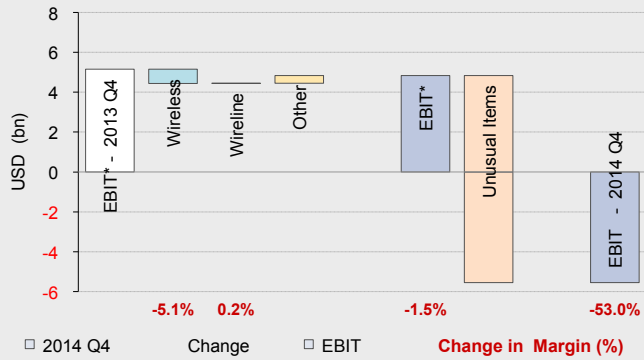
- Wireless Revenue rose \$1.4 bn (+8%) to \$19.9 bn.
- Wireline Revenue fell \$0.1 bn (-1%) to \$14.6 bn.
- Other Revenue fell \$2 m (-20%) to \$8 m.
- Total Revenue rose \$1.3 bn (+4%) to \$34.4 bn.

Revenues by Product

- Total Data Revenues rose \$1.2 bn (+6.2%) to \$19.7 bn.
- Total Voice Revenues fell \$2.0 bn (-19.0%) to \$8.6 bn.
- Total Other Revenues rose \$2.1 bn (+52.5%) to \$6.2 bn.

* = Excluding Unusual Items (prior year \$4.1 bn gain and \$6.8 bn loss this Q) mostly for pensions

YoY Change in EBIT* and Margins (%)



* = excludes Unusual Items.

EBIT by Division - Q4 2014

- Wireless EBIT fell \$0.7 bn (-18%) to \$3.2 bn. Margin fell 5.1% to 16.3%.
- Wireline EBIT rose \$11 m (+1%) to \$1.5 bn. Margin was flat at 10.1%.
- Other EBIT improved \$0.4 bn to \$140 m.
- Total* EBIT rose \$4.8 bn (+6.2%) to \$4.8 bn. Margin fell 1.5% to 14.0%.
- \$10.4 bn Unusual Items arose at the EBIT level. \$7.1 bn arose in Q4 last year.
- Q4 Total EBIT deteriorated \$17.8 bn to -\$5.6 bn. Margin fell 53.0% to -16.1%.

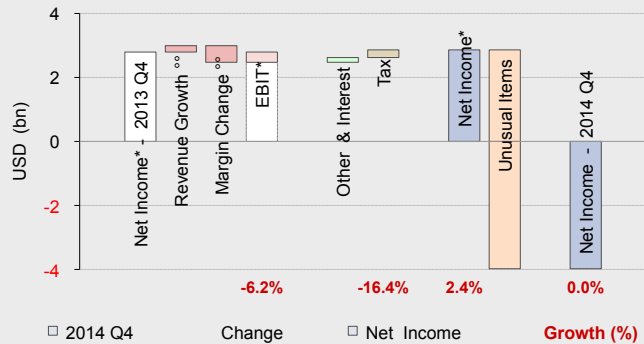
Notes - Unusual Items arising this Q and the prior year Q.

	2013 Q4	2014 Q4
At the EBIT level: (\$ bn)	7.1	-10.4
At the Net Income level: (\$ bn)	4.1	-6.8

- Unusual Items are detailed in the full (Company Profile) equity report.
- Growth rates and changes in margins are stated on a YoY basis.

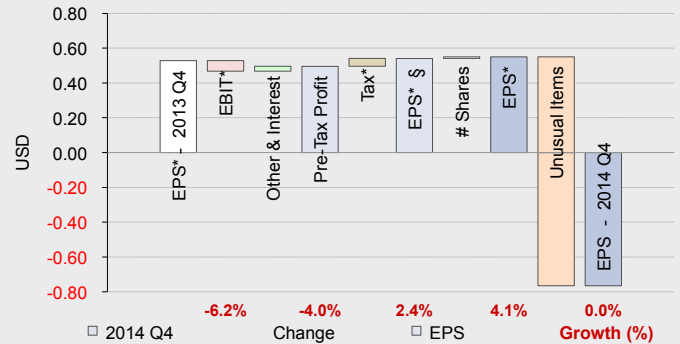
Shares = Share Repurchase / (Issues)

YoY Change in Net Income



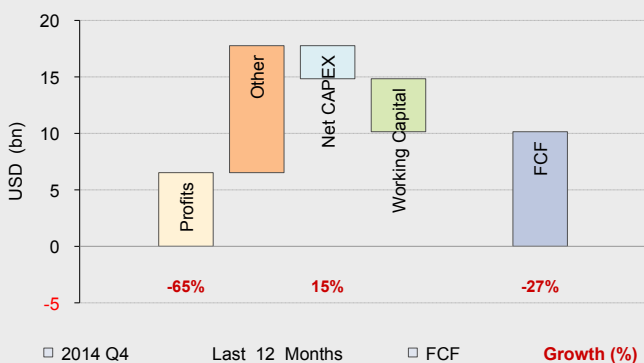
°° = Impact on EBIT "Other" = Other Income & Expenses
"Other Items" includes non-cash charges. Net CAPEX = Depreciation - CAPEX

YoY Change in EPS

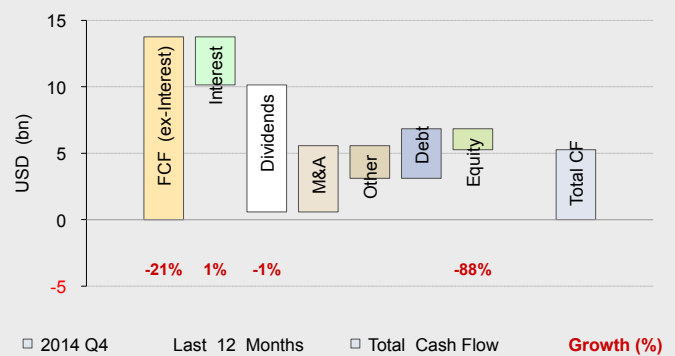


§ = EPS before share repurchases "Other" = Other Income & Expenses
Equity = Share Issues / (Repurchases) CF = Cash Flow

Free Cash Flows (FCF) - Last 12 Months

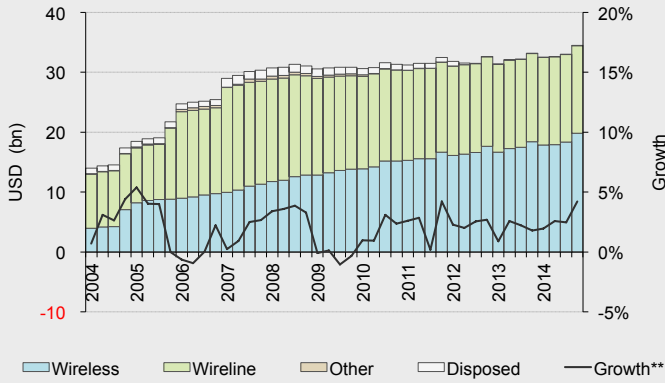


Total Cash Flows - Last 12 Months



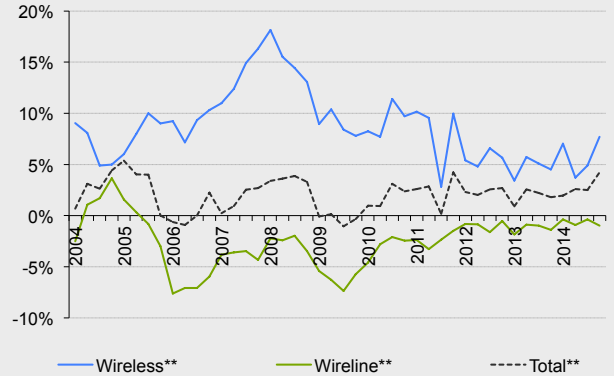
Historical Financial Results - Quarterly Analysis since 2004

Revenue by Division

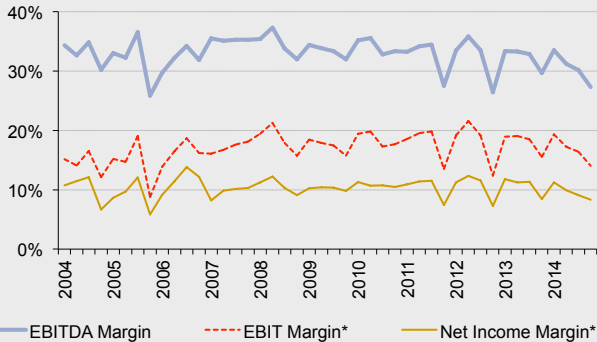


Growth** = Estimated revenue growth excluding major M&A charges.

Revenue Growth by Division



Profit Margins

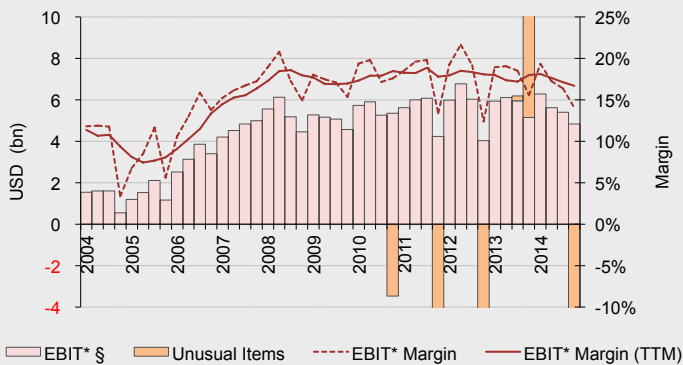


* = Excluding Unusual Items

EBIT Margins by Division



EBIT* & EBIT* Margin



TTM = Trailing 12 Months

* = Excluding Unusual Items

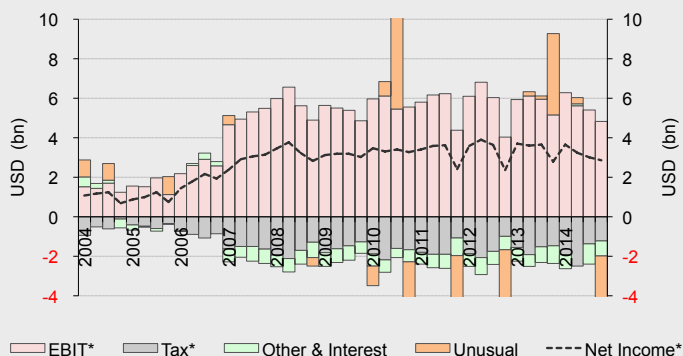
Key recent Unusual Items:

- 1) Q4 2014 includes post-tax charges of \$6.8 bn, mostly for an actuarial loss on pension plans and write-down of the fixed line network.
- 2) Q2 2014 includes a gain on sale of América Móvil shares.
Q4 2013 includes a net \$4.1 bn, mostly from a pre-tax \$7.6 bn
- 3) actuarial gain on retirement benefits.
- 4) Q2 2013, a small gain was made on the sale of América Móvil shares.
- 5) Q4 2011, includes \$13.4 bn (pre-tax) charges for asset impairment of the directories business, pension charges & failed T-Mobile acquisition.

Notes

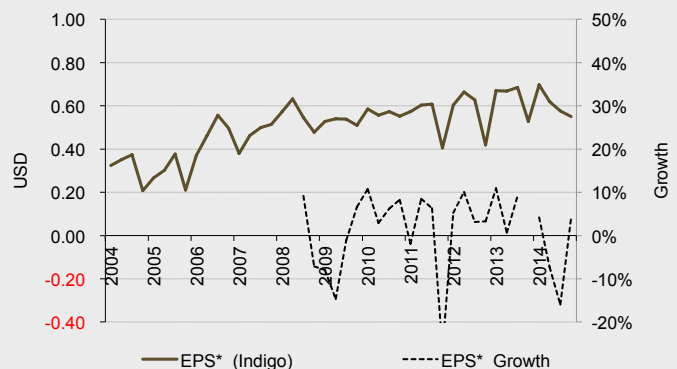
"Unusual" includes one-off, exceptional and extraordinary items. Most Unusual Items relate to acquisitions, disposals or restructurings. See the full report for more details of Unusual Items.

Net Income Analysis



"Other" includes non-operating items (eg. income from associates).

EPS* & EPS* Growth



* = Excluding Unusual Items

Key Fundamental Drivers

Key long-term, fundamental share price drivers:

(Graph)

- i, ii Share price performance is driven primarily by the PE* ratio and dividends; and secondly by EPS* growth. Which is contrast to normal dynamics.
- iii - v EPS* depends primarily on y EBIT* growth. Since 2011, EPS has been boosted slightly by share repurchases & lower tax rates.
- vi See the full report.

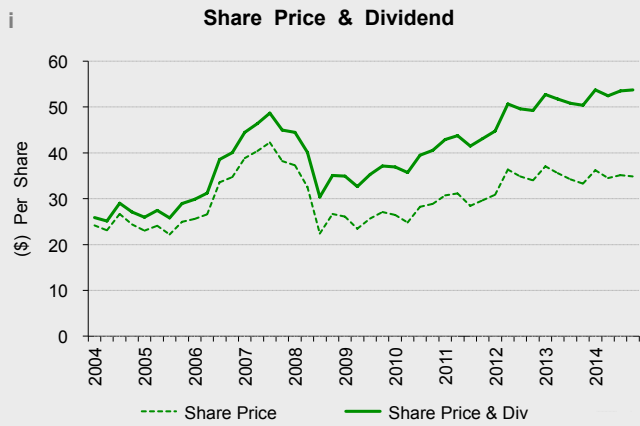
PE
↓
Share
Price

Analysis of fundamentals & EPS drivers:

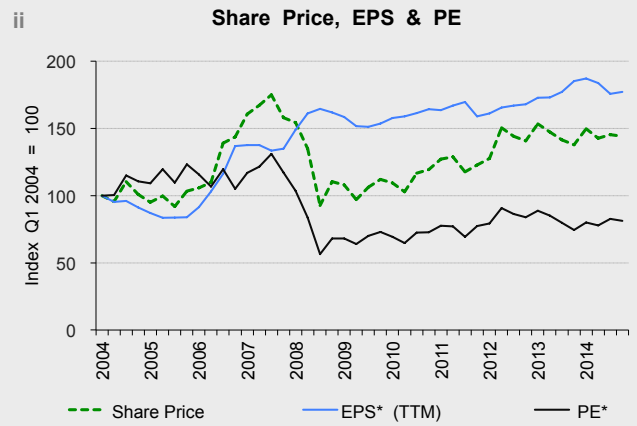
- See the full report.
- See the full report.
- See the full report.

(see also analysis on next page)

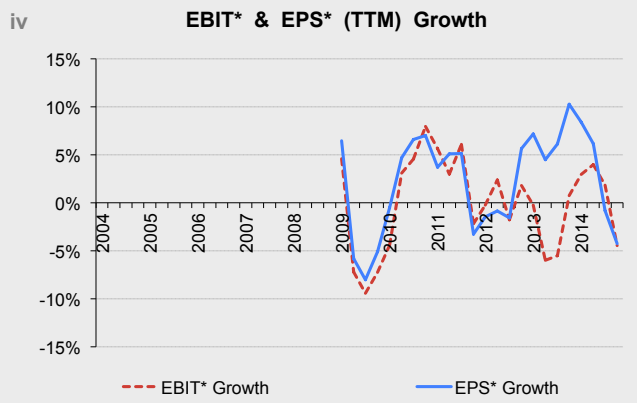
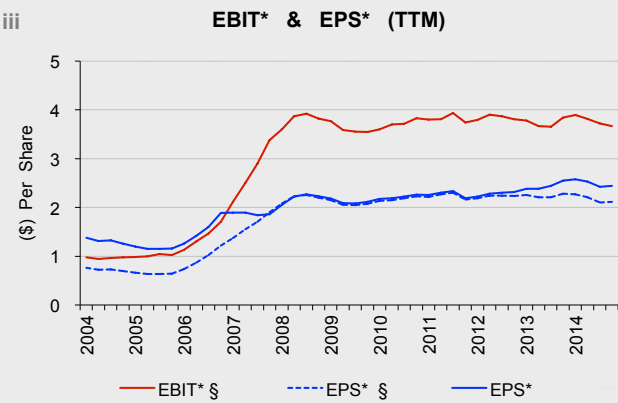
* = Excludes Unusual Items



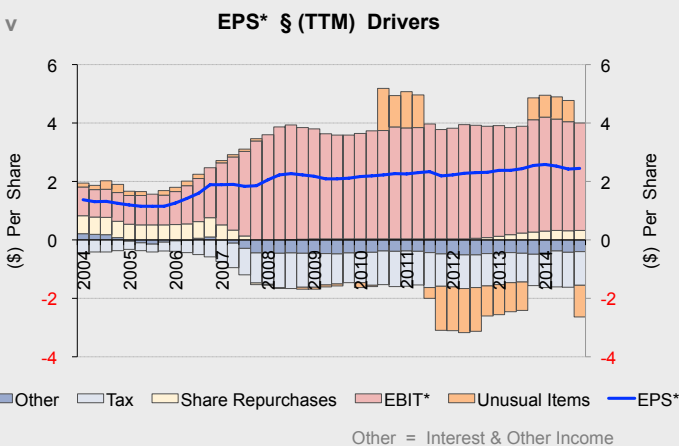
§ = Excluding the impact of any changes in # shares from Q1 2007. Excludes Unusual Items



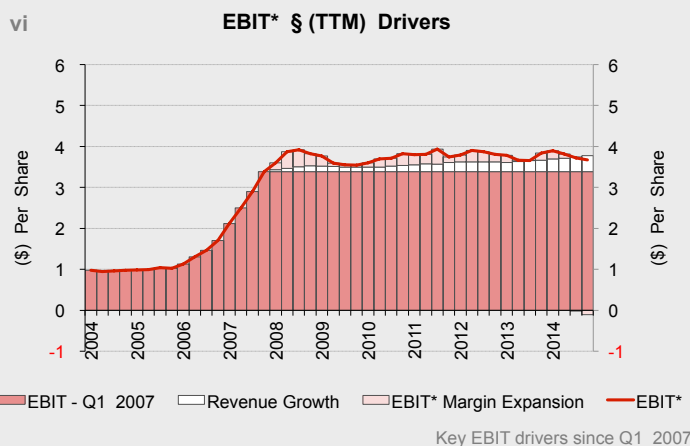
TTM = Trailing 12 months



EBIT* \$ (TTM) = Trailing 12 months EBIT, excluding Unusual Items & changes in # sha



Other = Interest & Other Income



Key EBIT drivers since Q1 2007.

Valuation

Fundamental Valuation

See the full report.

Fundamental Valuation

§ = Estimates for next 12 Months

	Last 12 Months	Base Case §	Change (%)
Share Price (\$)	See the full report.		
Dividends Per Share (\$)	See the full report.		
Return (incl. div.)	See the full report.		
Key Forecasts:			
Revenue Growth	2.9%	1.9%	-1.0%
EBIT* Margin	16.7%	14.2%	-2.5%
Tax Rate*	34.9%	36.9%	2.0%
EPS*	2.44	2.08	-14.9%
P / Sales	See the full report.		
P / EBIT*	See the full report.		
PE*	See the full report.		

* = Excluding Unusual Items

Note: See the full Indigo report for a more detailed description of the fundamental valuation.

Fundamental Valuation Methodology

The potential returns under the three scenarios (Bear, Base, Bull Cases) of the Fundamental Valuation above is a calculation based on an estimated change in share price and dividends received. The share price is calculated by multiplying the forecast PE and EPS. In turn, the EPS is calculated based on forecast changes in revenue, EBIT margin, net interest, other income & tax rates, and adjusting for share repurchases. This approach is summarized by the formula:

$$\text{Return} = \text{Dividends} + \Delta \text{Share Price}$$

$$\text{Return} = \text{DPS} + (\Delta \text{PE} * \Delta \text{EPS})$$

$$\Delta \text{EPS} = (((\Delta \text{EBIT} + \Delta \text{Interest} + \Delta \text{Other Income}) * \Delta \text{Tax Rate \%}) / \text{Shares}) * \Delta \text{Shares}$$

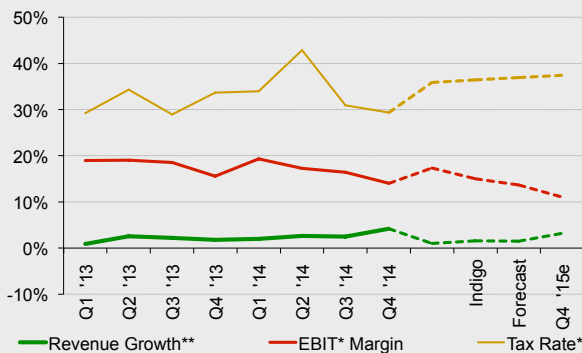
DPS = Dividends Per Share

Δ = Change in a variable

ie. Δ PE = Change in PE ratio

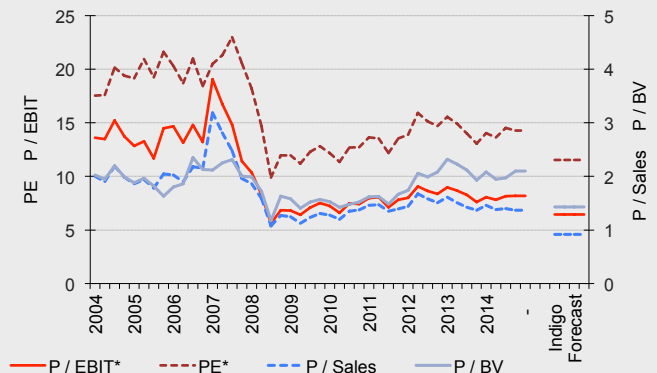
DISCLAIMER: The valuations and return calculations only illustrate the potential returns under the hypothetical conditions described and should not be relied upon for any investment decision. This is not an estimate of what we believe may occur, nor a price target nor a recommendation to buy or sell an investment.

Indigo Forecast Revenue Growth, EBIT Margin & Tax



* = Excluding Unusual Items

Historical Valuation Multiples



DCF Valuation

Current Share Price (\$)	34.9
WACC	6.4%
→ DCF Valuation (\$)	See the full report.

Reality check:

The current share price of \$34.85 and FCF in year 1 of \$2.01 imply the following ranges for FCF growth into perpetuity and WACC:

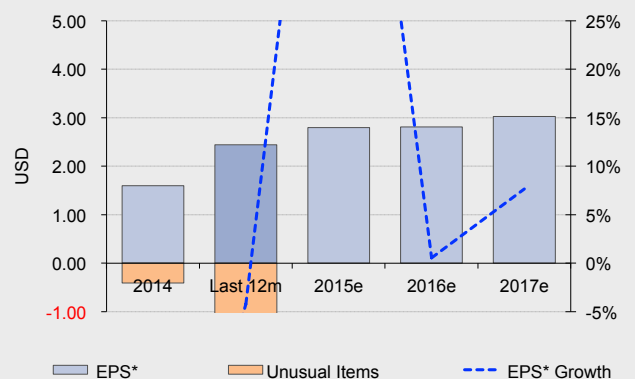
WACC See the full report.

FCF Growth into perpetuity See the full report.

DCF Formula: $PV = FCF / (WACC - g)$

Disclaimer: DCF valuation is only an illustration of potential valuation.

Consensus Forecasts - EPS



Explanations

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 company-specific risk of a sustained negative change in earnings, valuation ratios & investor sentiment; and thus the share price for more than one Quarter. This risk does not address the market risk. This risk does not include any measure of short term volatility, in the traditional financial academic sense, of less than one Quarter.

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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