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| **Company: AT&T Inc.** | Ticker: T Current Price: $ 33.54 | Sector: Telecom Services | Sub Industry: Integrated Telcom Services |
| Target Price: $70.10  Stop Loss: $26.82  52 Week High/ Low: $36.45/$30.97 | TTM P/E: 13.38  Forward P/E (1BF): 11.61  TTM EPS: $1.19 | Beta: .73  Credit Rating: BBB+ (S&P)  Rating Outlook: Stable | Market Cap: $201.1B  Avg. Vol (30 Day): 27.8M  Dividend Yield: 5.75% |

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| **Company Background:** |
| AT&T is the second-largest U.S. wireless carrier, serving more than 100 million customers. The firm is also provides local fixed-line services, including voice, data and television services, in 21 states. AT&T also provides phone and data services, such as data transport, to larger businesses nationwide. The firm recently acquired DirecTV, adding 20 million U.S. satellite television customers and a presence in Latin America. AT&T also recently closed two acquisitions in Mexico, adding 8.6 million wireless customers in the country. (Morningstar) |
| **Industry Outlook:** |
| Our fundamental outlook for the integrated telecommunication services (wireline) sub-industry for the next 12 months is neutral. We expect revenue pressure to remain, but think broadband growth and cost savings will yield modest free cash flow growth to support dividends. We have a positive opinion on select, high dividend paying companies within the sector. New versions of smartphones continue to drive wireless customer growth for the larger carriers. With more existing customers upgrading to high-end subsidized devices, we expect healthy wireless revenue growth, but also operating margin pressures over the next twelve months. In wireline, we expect continued access line weakness, but stable broadband subscriber gains. Competitive threats from cable and satellite providers should weigh on pricing and subscriber growth. However, we see continued cost cutting, merger synergies, and business market improvements supporting free cash flow. We expect telecom providers to continue to invest in high-demand fiber-based services to support broadband growth, with a focus on improving both data speeds and coverage. The government is phasing in regulatory changes to universal service funding to spur broadband availability, which we see as modestly negative for rural carriers. After dividend reductions by several mid-sized telecom companies in recent years, we believe dividend payout ratios for most are at levels that can support current attractive dividends. (S&P Capital IQ) |
| **Investment Thesis:** |
| Large capital allocations have been made recently, which include the acquisition of DirectTV, the foray in Mexico, and the substantial sum spent at the AWS-3 spectrum auction. AT&T's wireless unit, its largest segment at a bit more than 40% of sales, is its most attractive business. AT&T and Verizon Wireless have unmatched scale and resources to make the investments needed to continue meeting customer needs while generating strong margins and cash flow. AT&T has done a good job of capitalizing on its wireless position, driving improvements in customer service and cutting costs. AT&T now boasts a postpaid customer base that is nearly as loyal as Verizon Wireless'. Phone subsidies have hit margins, but the rapid shift to the Next financing model promises to better match phone costs and revenue. AT&T has wrapped up a period of heavy investment in its wireless network, which we expect will press its scale advantages versus smaller rivals over the next couple of years. The wireless industry has grown increasingly competitive recently, with T-Mobile attacking with new pricing options. We don't believe T-Mobile or Sprint can compete effectively on price over the long term because of the cost disadvantages they face in providing quality service. We believe AT&T has made intelligent pricing changes, encouraging heavier data usage, which showcases its network strength. In the fixed-line business, we believe the firm enjoys a strong position in the business services market thanks to the reach of its networks. At the high end of this market, very few competitors can meet customer needs as well. (Morningstar) |
| **Investment Risks:** |
| AT&T hopes that moderating network spending and continued revenue growth will enable cash flow to rebound in 2015 from a very weak level in 2014. However, a sustained drop in cash flow could hinder AT&T's ability to meet debt and other obligations on attractive terms or force the firm to cut its dividend. The ever-shifting market for telecom services could hinder future revenue growth. If smaller wireless carriers, such as Sprint, grow desperate and decide to compete even more aggressively on price to rebuild market share, AT&T could get caught in a tough spot. We don't expect these carriers will have the financial wherewithal to attack on price indefinitely, but undue retaliation from AT&T could harm profitability for an extended period. Competition for high-speed Internet access and television customers is also stiff. The firm has to balance capital investment to meet future customer demands, which are difficult to predict, and returns on investment. Growing competition from cable companies and wireless substitution has hurt the local phone business, still a major cash cow for AT&T. The firm may struggle to maintain margins as its fixed-line revenue base shifts to less profitable services, such as television. Changing regulation is also always a concern. DirecTV introduces a new set of risks to the business, as AT&T now relies more heavily on the traditional pay television model. (Morningstar) |
| **3-5 Takeaways From Last Quarter’s Investor Call Transcripts:** |
| * Increased full-year EPS outlook from $2.68 to $2.74 range, up from previous range of $2.62 to $2.68. * Increased full-year free cash flow to $15B+, up from previous range of $13B+. Currently the company’s payout ratio is 57 percent year-to-date (44 percent for Q3 2015), reassuring sustainable dividends and perhaps a dividend increase in FY2016. * Wireless EBITDA service margin expanded to record 49.4%, average revenue per user up 5% year-over-year, and more than 40% of smartphone base on Next financing plans (two-thirds off subsidy plans) . * 2.5 million total net adds (289,000 postpaid net adds, with 622,000 tablets and computing devices; Record 1.6 million connected device net adds including 1 million connected cars) * Foreign exchange rates have had negative impact on DirectTV Latin America results (Revenues down 25% driven by FX; Up 18% on a constant currency basis). However, it is important to note that this segment signifies a small portion of AT&T’s overall revenues (~2.4% of total revenue). |

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| **Financial Performance:** | **Discounted Cash Flow** |
| |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | |  | 2012 | 2013 | 2014 | Q1-2015 | Q2-2015 | Q3-2015 | | Revenue | 127,434.0 | 128,752.0 | 132,447.0 | 32,576.0 | 33,015.0 | 39,091.0 | | Operating Profit | 12,997.0 | 30,479.0 | 11,746.0 | 5,456.0 | 5,712.0 | 5,923.0 | | Net Income | 7,264.0 | 18,249.0 | 6,224.0 | 3,200.0 | 3,044.0 | 2,994.0 | | Revenue Growth (%) | 0.56% | 1.03% | 2.87% | 0.31% | 1.35% | 18.61% | | EBITDA (%) | 24.44% | 37.96% | 22.66% | 30.80% | 31.53% | 31.18% | | Operating Profit (%) | 10.20% | 23.67% | 37.96% | 16.75% | 17.30% | 15.15% | | Net Income Margin (%) | 5.70% | 14.17% | 4.70% | 9.82% | 9.22% | 7.66% | | D/E (%) | 75.35% | 81.75% | 94.41% | 110.73% | 129.91% | 103.37% | | Interest Coverage | 3.51 | 7.22 | 3.05 | 5.34 | 4.98 | 4.31 | | EPS | 1.25 | 3.39 | 1.19 | 0.61 | 0.58 | 0.50 | | PE Ratio | 14.62 | 13.45 | 13.38 | 13.47 | 14.25 | 13.18 | | Current Ratio | 0.71 | 0.66 | 0.86 | 0.73 | 1.07 | 0.73 | | ROE | 7.34 | 19.91 | 7.02 | 6.66 | 6.04 | 4.91 | | ROA | 2.68 | 6.63 | 2.18 | 1.99 | 1.74 | 1.53 | | Dividend Per Share | 1.77 | 1.81 | 1.85 | 0.47 | 0.47 | 0.47 | | |  |  |  | | --- | --- | --- | |  | 2001-14 | 2015-20 | | Avg. Revenue Growth | 1.28% | 4.20% | | Avg. EBITDA Margin | 33.0% | 32.0% | | Avg. NOPAT Margin | 12.0% | 12.0% | | Cost of Debt (After-Tax) | | 3.10% | | Tax Rate | | 29.95% | | Cost of Equity | | 7.55% | | WACC | | 5.80% | | Perpetuity Growth Rate (Terminal) | | 0.50% |   **Analyst Opinion**   |  |  |  | | --- | --- | --- | | Buy: 17 | Hold: 17 | Sell: 1 |  |  |  |  | | --- | --- | --- | |  | Rating | Target | | S&P NetAdvantage | 4-Star (Buy) | $39.00 (12 month) | | Morningstar | 3-Star | $33.00 (Fair Value) | | Value Line | Safety – 1  Timeliness – 3  Technical – 4 | $40- $50 (3-5 year) | |

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| **Relative Valuation** | **Total Return** |
| |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | |  | VZ US | BCE CN | TMUS US | RCI/B CN | Ind. Average | **T US** | | P/E | 11.42 | 15.55 | 42.54 | 16.85 | 37.84 | **13.18** | | P/B | 13.48 | 3.81 | 2.00 | 4.12 | 3.38 | **1.65** | | Dividend Yield | 4.94 | 4.53 | 0.00 | 3.71 | 2.35 | **5.75** | | PEG Ratio (BF12M) | 1.48 | 3.02 | 2.70 | 4.49 | 6.24 | **2.63** | | EPS (Last FY) | 2.42 | 2.70 | 0.31 | 2.35 | 0.67 | **1.19** | | Rev Growth (Last FY %) | 5.42 | 3.15 | 21.06 | 1.13 | 4.54 | **2.87** | | NI Growth (Last FY %) | -16.28 | 18.71 | 605.71 | -19.65 | 78.18 | **-65.89** | | Op Margin (Last FY %) | 15.42 | 22.03 | 4.79 | 20.74 | 7.92 | **8.87** | | Debt/Equity (Last FY %) | 828.25 | 131.89 | 156.30 | 285.28 | 194.45 | **94.41** | | Market Cap (USD) | 182.4B | 36.2B | 31.0B | 19.8B | 46.6B | **201.1B** |   **Prepared By: Alex Sadowski, 11/12/2015**  **Sources: Bloomberg, S&P NetAdvantage, VLIS, Morningstar** | |  |  |  |  | | --- | --- | --- | --- | |  | T | Sector | S&P 500 | | YTD | 2.92% | 2.72% | 2.61% | | TTM | -2.34% | -1.84% | 3.89% | | Last 3 Years | 4.10% | 5.35% | 17.02% | | Last 5 Years | 7.50% | 3.93% | 13.71% | | Last 10 Years | 7.50% | 6.33% | 7.58% |   **CSR Characteristics**   |  |  |  | | --- | --- | --- | |  | T | Industry | | ESG Disclosure | 50.62 | 30.34 | | Governance Disclosure Score | 66.07 | 57.47 | | Social Disclosure Score | 56.25 | 38.19 | | Environmental Disclosure Score | 40.65 | 38.54 | |