AT&T Inc. (T)

Updated April 22nd, 2020 by Eli Inkrot

Key Metrics

Current Price:	$30	**5 Year CAGR Estimate:**	13.9%	**Market Cap:**	$221.1 B
Fair Value Price:	$39	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	04/08/20
% Fair Value:	78%	**5 Year Valuation Multiple Estimate:**	5.0%	**Dividend Payment Date:**	05/01/20
Dividend Yield:	6.8%	**5 Year Price Target**	$47	**Years Of Dividend Growth:**	36
Dividend Risk Score:	B	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	2.0%

Overview & Current Events

While the history of AT&T dates back to Alexander Graham Bell and the original telephone in the late-1800's, the current iteration of the firm is rooted in a spun off "baby bell," SBC, that acquired AT&T Corp. in 2005 and changed its name to AT&T Inc. Today AT&T is the largest communications company in the world, operating in four distinct business units: AT&T Communications (providing mobile, broadband and video to 100 million U.S. consumers and 3 million businesses), WarnerMedia (including Turner, HBO and Warner Bros.), AT&T Latin America (offering pay-TV and wireless service to 11 countries) and Xandr (providing advertising). The $221 billion company generates $180+ billion in annual revenue.

On April 22nd, 2020 AT&T reported Q1 2020 results for the period ending March 31st, 2020. For the quarter the company generated $42.8 billion in revenue, down from $44.8 billion in Q1 2019, as growth in domestic wireless services and business services partially offset declines in domestic video, legacy wireline services and WarnerMedia. Net income equaled $4.6 billion or $0.63 per share compared to $4.1 billion or $0.56 per share in the year ago quarter. On an adjusted basis earnings-per-share equaled $0.84 compared to $0.86 previously, which does not include a -$0.05 impact from the COVID-19 crisis. AT&T's net debt-to-EBITDA ratio was ~2.6x at the end of the quarter.

Previously AT&T provided a 2020 outlook and 3-year financial guidance and capital allocation plan. For 2020 this included the expectation of revenue growth of 1% to 2%, adjusted earnings-per-share of $3.60 to $3.70 and a dividend payout ratio in the low-50% range. By 2022, AT&T expected 1% to 2% annual revenue growth, $4.50 to $4.80 in earnings-per-share, continued dividend increases and a debt-to-EBITDA ratio of 2.0x to 2.25x. However, due to the lack of visibility related to the COVID-19 pandemic AT&T has withdrawn its financial guidance at this time.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.29	$2.20	$2.33	$2.50	$2.50	$2.69	$2.84	$3.05	$3.52	$3.58	***$3.25***	***$3.95***
DPS	$1.68	$1.72	$1.76	$1.80	$1.84	$1.88	$1.92	$1.96	$2.00	$2.04	***$2.08***	***$2.28***
Shares[1]	5,911	5,927	5,581	5,226	5,187	6,145	6,139	6,139	7,282	7,255	***7,250***	***7,250***

AT&T is a colossal business, easily generating profits of $20+ billion annually, but it is not a fast grower. From 2007 through 2019 AT&T grew earnings-per-share by 2.2% per annum. While the company is picking up growth opportunities, notably in its recent acquisitions of DirecTV and Time Warner, we are cognizant of both the premiums paid and the fact that the company's legacy businesses are steady or declining. AT&T is optimistic about generating reasonable growth and the payout ratio had been falling, resulting in excess funds to divert toward paying down debt. Moreover, after the debt is under control, management has indicated the potential for share repurchases down the line. However, share buybacks have been suspended at this time. With the increased uncertainty in the short-term we have reduced our earnings estimate for this year, while keeping our growth forecast intact. Nevertheless, this still implies the potential for lower earnings over the intermedia-term.

[1] In millions.

Disclosure: This analyst is long the security discussed in this research report.

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.7	13.4	14.5	14.2	13.8	12.6	13.8	12.7	9.5	9.5	***9.4***	***12.0***
Avg. Yld.	6.3%	5.8%	5.2%	5.1%	5.3%	5.6%	4.9%	5.1%	6.0%	6.0%	***6.8%***	***4.8%***

During the past decade shares of AT&T have traded with an average P/E ratio of around 12 to 13 times earnings, with a range of 8 to 16. We believe something in the middle of that range is fair, given that new growth prospects are not yet proven, the dividend is robust, and the payout ratio is getting better. At the current valuation, there is the potential for a moderate uptick in valuation, even considering reduced earnings expectations for this year.

AT&T has a record of not only paying but also increasing its dividend for 36 consecutive years. Granted this payment has only been increasing by 4 cents annually since 2009, but it remains an important driver of shareholder returns. From this point, with a well above average dividend yield, protecting the payout is more important than growing it.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	73%	78%	76%	72%	74%	70%	68%	64%	57%	57%	***64%***	***58%***

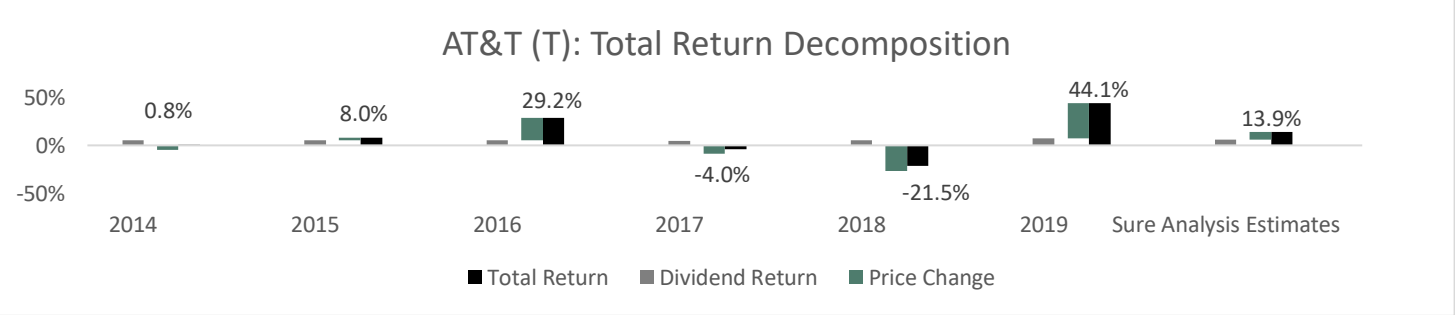
AT&T has a competitive advantage with its entrenched position in various important industries. Although this position could be eroding due to technological change, it remains that the company has direct contact with 170 million customers. The debt is an issue, but it is being addressed. At the close of the Time Warner merger it equaled $180 billion and the net-debt-to-adjusted EBITDA metric came in at 3.0x. By the end of 2018 this number got down to 2.8x. By the end of 2019 it was 2.5x. The goal is to get it down to 2.0x to 2.25x by 2022.

During the last recession AT&T posted results of $2.76, $2.16, $2.12 and $2.29 in earnings-per-share for the 2007 through 2010 period. The company did not eclipse its pre-recession high on an earnings basis until 2016, but the dividend did continue to grow throughout the entire period. Speaking of which, we are encouraged with the progress made on the dividend payout ratio. Some bemoan the slow rate of dividend growth, but we believe it has (and will continue to be) prudent given the company's current financial position.

Final Thoughts & Recommendation

Shares are down -18% since our last report. In our view AT&T faces two main challenges: a slow-moving business and a significant debt load. If it can overcome these obstacles the valuation multiple could expand. Total return potential is appealing, with a 6.8% starting yield, a 4% expected growth rate and the potential for a moderate improvement in valuation, adding up to a 13.9% prospective annual gain. We acknowledge the risks in the business, especially as it relates to the transition away from legacy businesses, but we believe the current value proposition makes up for a lot of this. We continue rate shares as a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue ($B)	124.3	126.7	127.4	128.8	132.4	146.8	163.8	160.5	170.8	181.2
Gross Profit	74023	71819	72206	77561	72302	79755	86596	82736	91337	97052
Gross Margin	59.6%	56.7%	56.7%	60.2%	54.6%	54.3%	52.9%	51.5%	53.5%	53.6%
SG&A Exp.	34986	41314	41066	28414	39697	32919	36845	35465	36765	39422
D&A Exp.	19379	18377	18143	18395	18273	22016	25847	24387	28430	28217
Operating Profit	19658	12128	12997	30752	14332	24820	23904	22884	26142	29413
Op. Margin	15.8%	9.6%	10.2%	23.9%	10.8%	16.9%	14.6%	14.3%	15.3%	16.2%
Net Profit	19085	3944	7264	18418	6442	13345	12976	29450	19370	13903
Net Margin	15.4%	3.1%	5.7%	14.3%	4.9%	9.1%	7.9%	18.3%	11.3%	7.7%
Free Cash Flow	15692	14633	19711	13852	10139	16662	16926	17363	22844	29233
Income Tax	-1162	2532	2900	9328	3619	7005	6479	-14.7B	4920	3493

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	269.4	270.4	272.3	277.8	296.8	402.7	403.8	444.1	531.9	551.7
Cash & Equivalents	1437	3045	4868	3339	8603	5121	5788	50498	5204	12130
Acc. Receivable	13610	13231	12657	12918	14527	16532	16794	16522	26472	22636
Goodwill/Int. ($B)	134.1	130.2	128.5	131.5	136.7	225.3	222.1	219.7	310.2	303.9
Total Liab. ($B)	157.4	164.6	179.6	186.3	206.6	279.0	279.7	302.1	338.0	349.7
Accounts Payable	7437	10485	12076	11561	14984	21047	22027	24439	27018	29640
LT Debt ($B)	66.2	64.8	69.8	74.8	81.8	126.2	123.5	164.3	176.5	161.1
Total Equity ($B)	111.6	105.5	92.4	91.0	89.7	122.7	123.1	140.9	184.1	184.2
D/E Ratio	0.59	0.61	0.76	0.82	0.91	1.03	1.00	1.17	0.96	0.87

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	7.1%	1.5%	2.7%	6.7%	2.2%	3.8%	3.2%	6.9%	4.0%	2.6%
Return on Equity	17.9%	3.6%	7.3%	20.1%	7.1%	12.6%	10.6%	22.3%	11.9%	7.5%
ROIC	10.7%	2.3%	4.4%	11.2%	3.8%	6.3%	5.2%	10.6%	5.7%	3.8%
Shares Out.	5,911	5,927	5,581	5,226	5,187	6,145	6,139	6,139	7,282	7,348
Revenue/Share	20.93	21.30	21.89	23.91	25.37	26.00	26.46	25.97	25.09	24.65
FCF/Share	2.64	2.46	3.39	2.57	1.94	2.95	2.73	2.81	3.36	3.98

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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