



## Business Description:

**AT&T Inc. (AT&T)** is a holding company that is focused on providing a broad range of telecommunication services to its customers. The products and services provided by AT&T include wireless communications, local telephone, long-distance, data/broadband and Internet, video, telecommunications equipment, managed networking, wholesale, directory advertising and publishing services. AT&T operates in three segments: 1) Wireless, 2) Wireline, and 3) Other. The wireless subsidiary provides wireless data and voice coverage to businesses and consumers. The wireline subsidiary utilizes Company's regional, nationwide, and global network to provide businesses and consumers with data and voice communications, high-speed broadband, video, voice services, and managed networking services. The Other segment includes AT&T's minority equity investments, and also includes costs to support corporate activities and operations.

## Investment Thesis:

- **AT&T is an established, large, US centric company with defensive characteristics providing a safe and reliable dividend stream with relatively low price volatility.** Whilst revenue growth of 0.75% CAGR\* over the past five years is a mark of a mature market and a predictable business model, AT&T's earnings before interest, taxes, depreciation and amortization (EBITDA) and earnings per share (EPS) have grown at 3.03% and 9.52%, respectively, over the same period. AT&T has continuously grown dividends since 1984, and continues to make share repurchases to enhance shareholder value.
- **AT&T benefits from an oligopolistic industry structure.** The wireless industry is a regulated oligopoly in the US that is dominated by AT&T, Verizon Communications Inc., T-Mobile US, Inc. and Sprint Corporation. AT&T had 110 million subscribers at the end of 2013, which represented a 33% market share in the US.

| Company                     | Market Share - Wireless<br>Q2, 2014 |
|-----------------------------|-------------------------------------|
| Verizon Communications Inc. | 34%                                 |
| AT&T Inc.                   | 33%                                 |
| Sprint Corporation          | 15%                                 |
| T-Mobile US, Inc.           | 14%                                 |
| Other Competitors           | 4%                                  |
| Company                     | Market Share - Wireline<br>2013     |
| AT&T Inc.                   | 30%                                 |
| Comcast Corporation         | 21%                                 |
| Verizon Communications Inc. | 20%                                 |
| Time Warner Cable Inc.      | 11%                                 |
| Other Competitors           | 18%                                 |

- **AT&T's strong balance sheet provides security and room for growth.** AT&T's high interest coverage and low debt levels relative to assets enables the company to finance cheap debt in the future for acquisitions. According to Moody's, AT&T has an investment credit rating of Baa1. The debt covenant ratios are below 3 times Debt/EBITDA.
- **Ownership of key network assets and capabilities.** AT&T owns a large spectrum of assets, including top wireless and wireline coverage zones across the US. AT&T is ideally positioned to take advantage of industry trends, leading to convergence of fixed and mobile communications and has been making strategic investments on the way to offering a multi-platform experience. It has been rolling out 1 Gbps (Gigabits per second) fiber services, while its acquisition of DirecTV shows the company commitment towards satisfying consumers' latest needs, such as over-the-top video (i.e. non-pay or third party video) content.
- **Recent acquisition in underserved market points towards growth in the future.** AT&T has agreed to acquire the third largest Mexican wireless operator, Iusacell, for a total of \$2.5 billion while assuming debt of \$700 million, marking the first US carrier to operate in Mexico. The agreement will give AT&T control of Iusacell's wireless network assets, retail locations, spectrum licenses, and a subscriber base of over 8.6 million consumers. This gives AT&T 10% market share in Mexico. Exposure to markets that are still in the early stages of wireless data and smartphone growth will allow AT&T to create a pan-North American mobile operator that will cover over 400 million people.
- **AT&T's wireline business is leveraged to the US economic growth.** With US being one of the few bright spots in the global economic environment, AT&T's largely domestic exposure provides the company with growth potential particularly in its wireline offerings geared towards enterprise and small and mid-sized corporate customers; further strengthening the company's defensive character on a backdrop of slowing global economic growth.

## Industry Growth Drivers/Trends: (Industry: Telecommunications)

- **Data hungry and increasingly mobile consumers.** The evolution of mobile and fixed networks, alongside the increased penetration of smartphones and tablets and increased multi-platform media consumption by users has led to the convergence of a wide array of platforms and technologies, which favours players with a strong presence in both fixed and mobile networks, as well as content capabilities.
- **Well positioned to take advantage of "the Internet of everything".** AT&T is at the center of the trend of enabling households to have smart home networking systems. Similar to how alarm systems require a home phone network, it is now becoming a reality that many other devices (coffee makers, heating systems, kitchen appliances, vehicle systems, etc.) will require a similar networking connection. AT&T has recently launched its home monitoring system (Digital Life), and has announced plans for car related security and entertainment services. This will result in consumers being more dependent on AT&T's bundled service offerings across many different platforms.



- **Net neutrality regulations back on the agenda with political discourse weighing on both sides.** By having net neutrality measures in place the Federal Communications Commission (FCC) will ensure that broadband providers such as AT&T, Comcast Corporation, and Verizon Communications Inc. will not be able to block or favour content groups (YouTube, Netflix, Hulu, etc.) using bandwidth. Conversely, broadband providers like AT&T, believe that content groups should pay a fee for consuming large chunks of bandwidth data. A proposal has been tabled and will likely be approved by the FCC, but likely challenged by the carriers in the US court system. Two previous proposals have been successfully challenged.

- **Lower cost wireless carriers (T-Mobile US, Inc. and Sprint Corporation) have launched successive price led challenges to larger operators.** Price competition has been increasing between mobile carriers via promotions and new phone upgrades leading to customer churn. AT&T has a strong balance sheet, a good ability to cut costs, and a large installed base of customers, giving the company a strong ability to fight a price war. Moreover, customers do not choose a provider solely because of price, with other factors, such as network quality and breadth of offering, including multi-platform capabilities and ability to bundle services being given increased consideration.

- **Growing penetration rates in the wireless market in Mexico.** The carrier's wireless network now covers over 70% of Mexico's market of 120 million people. The penetration rate of wireless broadband in Mexico is 14%, which is low when compared to developed economies (US = 100%, Japan = 112%, UK = 77%).

- **US Government plans to ensure that every American has access to broadband Internet by 2020 through the "Connect America Fund".**
  - The FCC plans will offer carriers financial incentives in the form of subsidies to expand their wireline distribution to 5 million rural Americans.
  - Penetration of rural communities is low relative to its urban counterparts. According to a June 2012 report from the National Broadband Map, 99.6% of the population in urban areas has access to available broadband speeds of at least 6 Mbps (Megabits per second), as opposed to just 81.8% of the population in rural areas.

## Competitive Advantages:

- Established customer base
- Deep spectrum holdings
- Strong brand identity
- Retail locations are easily accessible nationwide

## Competitors:

| Wireless Segment            | Wireline Segment            |
|-----------------------------|-----------------------------|
| Verizon Communications Inc. | Verizon Communications Inc. |
| T-Mobile US, Inc.           | Comcast Corporation         |
| Sprint Corporation          | Time Warner Cable Inc.      |

## Customers:

- **Consumer** – Sells telecom services to retail customers.
- **Business** – Sells telecom services to business clients.

## Barriers to Entry:

- **Loyal customer base**
- **Economies of scale** required to be able to compete.
- **Regulated oligopoly.** Wireless spectrum is difficult to come by and is auctioned to the most capable firms that are few in number.
- **New networks take long to build.** To build out a rival network to compete with the Big 4, providers will require a lot of capital, and significant lead time before being commercially available to the same customer base.

## Officers and Directors:

- AT&T has a 14 member Board of Directors. The majority of the board is comprised of independent directors. The Chairman & Chief Executive Officer, Randall J. Stephenson, has served in his current role since 2007.

## Corporate Governance:

- The compensation for AT&T's top management during 2013 was only 0.18% of company's earnings before interest and taxes.

## Ownership(% Shares Outstanding):

- Notable holders as of April 1, 2015 include the following: The Vanguard Group, Inc. - 5.4%, State Street Global Advisors - 4.5%, Evercore Trust Company, N.A. - 4.2%, Blackrock Institutional Trust Company, N.A. - 4.0% and Dimensional Fund Advisors, L.P. - 0.9%.

## Capital Allocation/Uses:

- In 2014, AT&T announced the acquisition of DirecTV for \$48.5 billion, which significantly enhances the company's offering in a multi-platform context, while providing significant economies of scale and reduced content costs. AT&T also invested around \$4 billion in Mexican telecom networks.
- AT&T spent \$21 billion on capital expenditures (CAPEX) during 2013, mostly on growing and maintaining its wireline and wireless networks. Capital expenditures for wireless network accounted for 52% of total spend, while the capital expenditures for the wireline network accounted for 48%. The company spent an additional \$4 billion on making targeted vertical and horizontal acquisitions. Going forward, it is expected that the company will make further acquisitions to expand its foothold across North America (including Mexico), and increase CAPEX to improve on its newly acquired networks.
- AT&T spent \$18.2 billion for US wireless spectrum during the most recent advanced wireless spectrum (AWS-3) auction, being the largest bidder in the process, seconded by Dish Network Corp, and Verizon Communications Inc, which spent \$13.3 billion and \$10.4 billion, respectively. This investment will help secure AT&T's leadership in network capabilities and enable it to upgrade the quality of service for its data hungry customers.
- AT&T's top strategic priorities for its CAPEX program is to increase network reliability for both its wireless and wireline networks, improve efficiency through increasing the "softwareification" of its network and footprint optimization.



- As a member of the S&P 500® Dividend Aristocrats® Index, AT&T has a policy of increasing its dividend every single year. In 2014, AT&T announced a 2% increase in its annual dividend. During 2014, AT&T also generated \$9.9 billion in free cash flow, implying a 97% coverage of its dividends in terms of free cash flow. AT&T is guiding for improved free cash flow and dividend coverage in 2015.
- Besides pursuing a number of significant acquisitions recently, AT&T has also been focusing on streamlining its portfolio of assets worth \$300 billion by divesting non-core operations in order to further strengthen its balance sheet.

| <b>Financial Statement Summary (Years ended December 31, in millions US\$):</b> |         |         |         |         |         |
|---|---------|---------|---------|---------|---------|
|   | 2013    | 2012    | 2011    | 2010    | 2009    |
| <b>Income Statement</b>   |         |         |         |         |         |
| Total Revenue   | 128,752 | 127,434 | 126,723 | 124,280 | 122,513 |
| EBITDA  | 49,470  | 31,274  | 27,844  | 39,830  | 40,667  |
| Earnings per Share (Continuing Operations)                                      | 3.4     | 1.2     | 0.7     | 3.2     | 2.1     |
| Dividend per Share  | 1.8     | 1.8     | 1.7     | 1.7     | 1.7     |
| Dividend Yield  | 5.15%   | 5.25%   | 5.72%   | 5.75%   | 5.89%   |
| <b>Balance Sheet</b>  |         |         |         |         |         |
| Total Debt  | 74,788  | 69,844  | 64,753  | 66,167  | 72,081  |
| Debt : EBITDA   | 1.51    | 2.23    | 2.33    | 1.66    | 1.77    |
| Total Debt : Total Equity   | 82%     | 76%     | 61%     | 59%     | 71%     |
| <b>Cash Flow Statement</b>  |         |         |         |         |         |
| Operating Cash Flow   | 34,796  | 39,176  | 34,648  | 34,993  | 34,445  |

| <b>Key Ratios and Figures (Years ended December 31):</b> |      |      |      |
|--|------|------|------|
|  | 2013 | 2012 | 2011 |
| EBITDA Margin  | 38%  | 24%  | 22%  |
| Interest Coverage  | 7.2  | 3.5  | 6.1  |
| Return on Invested Capital                               | 13%  | 6%   | 4%   |

| <b>Geographic Segments (Years ended December 31, in millions US\$):</b> |        |        |        |
|---|--------|--------|--------|
|   | 2013   | 2012   | 2011   |
| <b>Wireless</b>   |        |        |        |
| Data  | 21,719 | 18,297 | 14,861 |
| Voice/Text/Other  | 39,833 | 40,889 | 41,865 |
| Equipment   | 8,347  | 7,577  | 6,489  |
| <b>Wireline</b>   |        |        |        |
| Data  | 33,593 | 31,841 | 29,548 |
| Voice   | 20,333 | 22,614 | 25,121 |
| Other   | 4,888  | 5,118  | 5,480  |
| <b>Other</b>  |        |        |        |
| Segment Revenue   | 39     | 49     | 66     |

Sourced from Thomson Reuters and Company Reports

\*CAGR - Compound Annual Growth Rate

Any references to "dollars" or "\$" are to the United States dollar, unless otherwise indicated.

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