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AT&T Inc. (T)

Initiating Coverage with a Buy Rating and Price Target of $18

Primary Report – Revised (see back page) **August 1, 2023**

AT&T reported 23Q2 results that slightly exceeded guidance and consensus estimates. The results also raised confidence that the company can achieve its 2023 free cash flow target of $16 billion.

Its key end markets, prepaid wireless service and broadband, have matured in many geographies, limiting its growth potential and potentially intensifying competition. The company is responding by focusing on cutting operating expenses, reducing its real estate footprint and replacing legacy copper infrastructure. In 23Q2, it achieved its $6 billion cost savings target and aims to realize $2 billion more over the next 3 years.

In 2024, AT&T will complete the rollout of mid-range C-band spectrum, bringing faster connectivity, greater bandwidth, lower latency and new use cases to its 5G mobility network. It is also expanding its broadband coverage to win new subscribers and increase the network's data capacity. Its Gigapower joint venture (with Blackrock) aims to bring broadband to areas outside of its service territory, potentially tapping $42.5 billion of funding from the Federal government to expand affordable broadband service.

A WSJ exposé on lead-sheathed cables has raised concerns that AT&T (and its peers) may face billions of dollars in remediation costs. However, the company asserts that these cables, which have been in use for decades, are safe. The EPA and certain state and local governments are now examining the issue. AT&T may have to spend more to remediate certain problem areas, but it is unlikely, in my view, that such costs will be devastating to the company and its shareholders.

AT&T's stock has fallen 21.5% YTD vs. the S&P 500's 19.3% gain. Most of the selloff occurred after 23Q1 results on disappointing free cash flow which raised concerns about its leverage and dividend sustainability. The stock took another dive after the WSJ exposé, but showed little response to 23Q2 results that put the company back on track to meet its 2023 free cash flow objective of $16 billion.

I am initiating coverage of AT&T with a Buy rating and price target of $18. The price target is based upon an assumed one-year forward P/E multiple of 8 times projected 2024 GAAP earnings of $2.23 and 7 times projected 2024 non-GAAP earnings of $2.51. From the current share price of $14.45, my $18 target price equates to a potential total return of 32%, including the stock's 7.7% dividend yield.

Common Stock Performance Rating: 1; Safety Rating: D+ **S&P 500: 4582.23 (7/28)**

Amt Outst ($m)	CUSIP	Type	Recent Price	Coupon	Maturity	Yield	Spread	Call Date (a)	Call Price	Credit Ratings
3,000	00206RML3	Senior Notes	90.86	1.70%	3/25/26	5.45%	85	8/6/23	100.0	Baa2/BBB
2,250	00206RKG6	Senior Notes	85.30	1.65%	2/1/28	5.37%	110	12/1/27	100.0	Baa2/BBB
3,000	00206RJY9	Senior Notes	83.11	2.75%	6/1/31	5.42%	143	12/1/28	100.0	Baa2/BBB
2,500	00206RJZ6	Senior Notes	74.67	3.50%	6/1/41	5.80%	155	12/1/40	100.0	Baa2/BBB
7,500	00206RKJ0	Senior Notes	68.20	3.50%	9/15/53	5.73%	170	3/15/53	100.0	Baa2/BBB

(a) The notes are callable at any time subject to make whole provisions.

Shares Outst. (mil.)	Common Stock	7/28/23 Price	Div. per Share	Div. Yield	Tangible Book Val.	GAAP Proj '23 EPS	2023 P/E	GAAP Proj. '24 EPS	2024 P/E
7,168.0	AT&T Inc. (T)	$14.45	$1.11	7.7%	$3.29	$2.32	6.3	$2.23	6.6

Tangible book value excludes goodwill and other intangible assets. Non-GAAP EPS projections are $2.45 for 2023 and $2.51 for 2024.

Business. Originally known as SBC Communications, one of the regional telephone companies created in the break-up of AT&T Corp. in 1984, the company grew through a series of mergers and acquisitions, including the acquisition of its former parent, AT&T Corp., in 2005. AT&T Inc. is now the largest integrated telecommunications services provider in the U.S.

In 2015, AT&T acquired DIRECTV, a leading provider of digital television entertainment services with operations in the U.S. and Latin America. In 2018, it completed the acquisition of Time Warner Inc. for nearly $72 billion in cash and stock.

With the Time Warner acquisition, AT&T had hoped to lead the changes taking place in the industry (e.g. the streaming of unbundled entertainment services) by combining Time Warner's leading content creation with AT&T's direct-to-consumer distribution. However, the company struggled from the outset to achieve this vision, in part because of the significant cultural differences between Time Warner and AT&T.

AT&T eventually opted to reverse course and return to its telecommunications networking roots. In July 2021, it formed DIRECTV Entertainment Holdings, LLC with TPG Capital to hold its interests in DIRECTV and its AT&T TV and U-verse video services. In the transaction, AT&T exchanged its U.S. video business unit, including DIRECTV, AT&T TV and the U-Verse video services, for $7.1 billion of cash, preferred stock and 70% of the equity in the new venture. TPG invested $1.8 billion in preferred stock which has since been repaid. Although AT&T has a 70% equity stake, the joint venture is accounted for under the equity method because TPG has authority on certain key decisions, including the CEO's employment.

In April 2022, AT&T spun off its Warner Media business, combining it with Discovery, Inc. to form Warner Bros. Discovery, Inc. (WBD). AT&T shareholders received 0.241917 shares of WBD common stock for each AT&T share that they owned, worth about $8.20 per AT&T share at the time of the announcement in May 2021 and giving AT&T shareholders a collective 71% equity stake in WBD. AT&T also received $40.4 billion in cash in the deal.

With these divestitures, AT&T now operates in two business segments: Communications and Latin America. Its Communications business (97.4% of 2022 segment revenues and >100% of 2022 segment operating income) provides wireless and wireline telecommunications and broadband services to consumers in the U.S. and businesses globally. The segment's business units include the Mobility, Business Wireline and Consumer Wireline.

Mobility (68.0% of 2022 segment operating revenues, 85.2% of segment operating income) provides wireless service and equipment throughout the U.S. It is the third largest service provider, as measured by prepaid and postpaid subscribers, behind T-Mobile and Verizon Wireless. In 2022, Mobility had $81.8 billion of revenues, $32.7 million of EBITDA, $24.5 of operating income and 217.4 million devices connected through subscriptions.

Mobility competes with the two national service providers and with smaller regional companies. The wireless market is mature. Changes in Mobility's subscriber base are now driven mostly by customers switching and by adding extra phone service lines and connecting other devices - such as tablets, wearables, (wholesale) automobile systems, and commercial and industrial monitoring equipment. Other devices are mostly added to existing accounts and generate lower average monthly revenues than basic (prepaid and postpaid) wireless service.

AT&T has high hopes for its midrange C-band wireless service. This upgrade utilizes the mid-band spectrum from 2.4GHz to 4.0GHz and provides faster connectivity, greater bandwidth and lower latency compared to the 4G standard. Initial concerns about interference with air traffic communications, especially near airports, delayed the rollout for two years. With that concern now resolved, the rollout is proceeding and is expected to be complete by the end of 2024. In its 23Q2 earnings release, the company said that its mid-band 5G spectrum now covers 175 million people and is on track to reach 200 million by the end of the year.

Mobility is AT&T's core business. It accounts for more than 100% of the company's consolidated operating income. While other segments of AT&T's business – like broadband and perhaps Latin America - have the potential to grow at above average rates going forward, Mobility is and will remain the focus of AT&T.

With the rollout of the mid-band spectrum, AT&T anticipates an increase in the number of use cases for 5G service. This should drive new business models that take advantage of the enhanced network capabilities. The company expects therefore that the value proposition of its network will rise and so it is preparing to capitalize on the opportunity by beefing up its network infrastructure, architecture and service capabilities. It aims to assist entrepreneurs and other organizations who want to tap into the network's enhanced capabilities.

Table 1

AT&T Inc. (T)

Mobility Results – 2020-2023

($ mil.)

	12 Months 31-Dec-20	12 Months 31-Dec-21	12 Months 31-Dec-22	6 Months 30-Jun-22	6 Months 30-Jun-23
Operating revenue					
Service	55,542	57,590	60,499	29,728	31,228
Equipment	17,022	20,664	21,281	10,273	9,669
Mobility operating revenues	72,564	78,254	81,780	40,001	40,897
Percent growth		7.8%	4.5%	5.3%	2.2%
Operating expenses					
Operations and support	42,106	47,453	49,770	24,188	23,792
as % of revenues	58.0%	60.6%	60.9%	60.5%	58.2%
Depreciation & amortization	8,086	8,122	8,198	4,076	4,221
Total operating expenses	50,192	55,575	57,968	28,264	28,013
Operating income	22,372	22,679	23,812	11,737	12,884
Operating income margin	30.8%	29.0%	29.1%	29.3%	31.5%
EBITDA	30,458	30,801	32,010	15,813	17,105
EBITDA margin	42.0%	39.4%	39.1%	39.5%	41.8%

Source: AT&T's financial statements and earnings press releases.

Recent financial results for Mobility highlight both the maturation of consumer demand and the company's focus on reducing operating costs. With the pandemic-driven surge in demand now having faded away, revenue growth has slowed over the past 30 months to a low single-digit rate in 23H1. However, Mobility's operating margin improved by 220 bp to 31.5% in 23H1, primarily because of AT&T's cost savings initiatives.

Slowing growth can invite heightened competition, especially if the industry has significant excess capacity. One concern is the effort by cable providers, such as Comcast and Charter. to offer discounted wireless service (which they obtain on a wholesale basis from Verizon Wireless) to their customers to prevent them from discontinuing their cable service. AT&T, however, says that despite changes made by competitors to their service offerings, which seek to offset the increase in operating costs due to inflation and other factors, the industry is seeking to protect margins. AT&T has held the line on pricing and has avoided chasing unprofitable business. That may result in some market share slippage, but the company believes that this will serve it better in the long run.

On July 26, DISH Network announced a partnership agreement with Amazon to provide unlimited talk, text and data service to Prime subscribers for $25 per month. There are obvious concerns that the new offering will put additional pressure on wireless service prices. However, DISH's network currently covers only 70% of the U.S. Price conscious Prime subscribers may be inclined to switch, but it seems more likely that those who do opt for the service will add it as a cheap second line.

AT&T has invested more than $33 billion to obtain midrange spectrum licenses across its operating territory. It is now investing both to upgrade its wireless networking and broadband infrastructure. Besides facilitating the growth of its wireline businesses, the stepped-up broadband investment will increase the data throughput capacity of AT&T's system in densely populated areas to accommodate an expected 5X increase in data traffic over the next several years. The company expects that capital spending (defined as capital expenditures plus vendor financing payments) will peak at $24 billion this year, but it has not offered any guidance for capital spending yet on capital spending for 2024 and beyond.

It is uncertain, however, whether AT&T will earn an adequate return on its ongoing investment in its wireless networks. Of course, the company must keep its network capabilities up to date to avoid losing ground to the competition. Still, as data volumes are rising, most consumers are satisfied with the quality of their connections. They may be unwilling therefore to pay more for improved service, especially in a tighter economic environment. Accordingly, support for continuing this high level of investment appears to rest on whether new use cases are sufficiently attractive to generate new (or improved) revenue streams.

Business Wireline (18.8% of 2022 segment operating revenues, 11.2% of segment operating income), provides telecommunications services to businesses and organizations of all sizes, including multinational corporations, governments and wholesalers. It offers advanced internet-protocol-based services, such as ethernet, dedicated internet service and virtual private networks, along with data, cloud and security solutions and outsourced or managed professional services.

Some legacy services, such as basic telephone service, have been in a secular state of decline for decades. This is the primary cause of the multi-year decline in Business Wireline's revenues and profitability. AT&T is focused on replacing those services and seeks to grow the business with new services utilizing 5G and fiber broadband; but the gains from these new services has not yet offset the losses from legacy services, as shown in the business unit's financial performance in the table on the next page.

Also included in that table is the supplemental disclosure for Business Solutions, which shows the combined results of its Business Wireline and business wireless services. (The results for business wireless are included in the Mobility business unit.)

So far in 2023, Business Solutions has generated operating revenues of $8.4 billion per quarter and operating income of about $1.0 billion. Although both are down vs. the prior year, EBITDA for the unit is nearly flat. That suggests that AT&T is making some headway in stabilizing the profitability (or operating cash flow) of the business with the significant investments that it is making in both wireless and broadband infrastructure, but its return on investment in Business Solution, given the continued high level of capital spending, is still probably on the decline.

Table 2

AT&T Inc. (T)

Business Wireline Results – 2020-2023

($ mil.)

	12 Months 31-Dec-20	12 Months 31-Dec-21	12 Months 31-Dec-22	6 Months 30-Jun-22	6 Months 30-Jun-23
Operating revenue					
Service	24,313	23,224	21,891	10,894	10,314
Equipment	770	713	647	341	296
Mobility operating revenues	25,083	23,937	22,538	11,235	10,610
Percent growth		-4.6%	-5.8%	-7.1%	-5.6%
Operating expenses					
Operations and support	15,303	15,653	14,934	7,494	7,173
as % of revenues	61.0%	65.4%	66.3%	66.7%	67.6%
Depreciation & amortization	5,216	5,192	5,314	2,612	2,663
Total operating expenses	20,519	20,845	20,248	10,106	9,836
Operating income	4,564	3,092	2,290	1,129	774
Operating income margin	18.2%	12.9%	10.2%	10.0%	7.3%
EBITDA	9,770	8,284	7,604	3,741	3,437
EBITDA margin					
Business Solutions (Supplemental)					
Operating revenue	35,697	35,512	34,896	17,317	16,811
Total Wireless revenues	10,614	11,575	12,358	6,082	6,201
Operating income	6,780	5,091	4,570	2,196	2,043
EBITDA	13,280	11,661	11,319	5,522	5,482

Source: AT&T's financial statements and earnings press releases.

Consumer Wireline (10.6% of 2022 segment operating revenues, 4.6% of segment operating income). Here too, AT&T's legacy businesses, such as plain old telephone service, have been on the decline for years. Its focus is on growing the fiber broadband business, replacing POTS and older broadband technologies such as DSL over time. It is also seeking to expand its geographic footprint in fiber broadband to take market share from existing cable providers.

Fiber broadband benefits consumers by providing them with a better quality service and increasing the capacity of the system to manage data flow. It is also less costly to manage and maintain. However, the key question is whether the consumer appreciates that enough to opt for fiber over other less costly alternatives, namely 5G fixed wireless service. Fixed wireless has seen a relatively rapid uptake among consumers because it offers acceptable data speeds at a cost that is below the standard pricing of broadband companies, including cable.

Many industry watchers therefore see fixed broadband as a disruptive service. The service can be rolled out at the margin for the cost of the equipment, saving the significant cost (of perhaps as much as $2,000-$4,000 per subscriber) of bringing fiber to the customer's doorstep. The data speeds offered by fixed wireless are slower than fiber (but still adequate for many households). There is also a limit as to fixed wireless service providers' capacity to take on and manage the rapid growth in home data usage without expanding their (fiber) data backbone capacity. This is perhaps the main reason AT&T has been lukewarm about the prospects for fixed wireless, even though its own fixed wireless product, AT&T Internet Air, reportedly has 500,000 subscribers.

Table 3

AT&T Inc. (T)

Consumer Wireline Results – 2020-2023

($ mil.)

	12 Months 31-Dec-20	12 Months 31-Dec-21	12 Months 31-Dec-22	6 Months 30-Jun-22	6 Months 30-Jun-23
Operating revenues					
Broadband	8,534	9,085	9,669	4,748	5,088
Legacy voice and data services	2,213	1,977	1,746	905	779
Other service and equipment	1,571	1,477	1,334	682	623
Total operating revenues	12,318	12,539	12,749	6,335	6,490
Percent growth		1.8%	1.7%	1.6%	2.4%
Operating expenses					
Operations and support	8,027	8,922	8,946	4,480	4,510
as % of revenues	65.2%	71.2%	70.2%	70.7%	69.5%
Depreciation & amortization	2,914	3,095	3,169	1,551	1,718
Total operating expenses	10,941	12,017	12,115	6,031	6,228
Operating income	1,377	522	634	304	262
Operating income margin	11.2%	4.2%	5.0%	4.8%	4.0%
EBITDA	4,291	3,617	3,803	1,855	1,980
EBITDA margin	34.8%	28.8%	29.8%	29.3%	30.5%

Source: AT&T's financial statements and earnings press releases.

While there is still more work to do, it does appear that AT&T has made progress in reversing the declines in its Consumer Wireline business. Operating revenues were up mid-single digits in 2022 and 23H1, despite ongoing declines in the legacy voice and data services and other service and equipment parts of the business. EBITDA also improved in both of those periods.

Communications Segment

At another level, with all three business units sharing some parts of the company's network infrastructure, it makes sense to evaluate the Communications segment as a standalone entity. In 23H2, revenues for the segment increased 0.7% to $58.0 billion, while operating income increased 5.7% to $13.9 billion. EBITDA similarly rose 5.2% to $22.5 billion. Capital spending, including vendor financing, declined from $12.5 billion in 22H1 to $12.0 billion in 23H1. While assets for the segment are disclosed only on an annual basis, the available efficiency measures show that the segment earns decent returns on investment: its ratio of operating income to average assets improved 30 bp to 5.8% in 2022 and its ratio of EBITDA-to-average assets rose by 50 bp to 9.4%.

Although about 70% of AT&T's capital spending is targeted mostly toward Mobility, the remaining 25%-30% for broadband infrastructure benefits the entire segment. As noted, by increasing data throughput capacity, the investment in broadband supports all three businesses, but a significant portion of the broadband investment is also aimed at growing the Business and Consumer Wireline businesses. Yet so far at least, the gains in broadband subscribers have been only modest and probably not supportive of continued accelerated investment longer term.

For that reason, AT&T is looking at alternatives to fund the build-out of its broadband infrastructure. The company is pursuing government funds that are available to expand broadband coverage throughout the U.S., primarily from the $42.5 billion Broadband Equity, Access and Deployment Program (BEAD) established under the Infrastructure Investment and Jobs Act of 2021. The BEAD program aims to develop and deploy broadband services, provide subsidies to lower-income households to offset the cost of internet service and create training programs for consumers for devices and upgraded networks.

In May, AT&T joined with money manager, BlackRock, to form the $1.5 billion Gigapower joint venture. Gigapower plans to develop state-of-the-art fiber networks for internet service providers and businesses in certain metropolitan areas through a commercial wholesale open access platform. Its focus will be on geographic areas not already served by AT&T. It presumably will seek access to BEAD funding and will also use debt to finance its operations. Its first networks will be built in Las Vegas, Chandler and Gilbert AZ, and parts of northeastern Pennsylvania, Alabama and Florida. AT&T itself will become a wholesale customer of Gigapower in certain markets.

Latin America. With 21.7 million subscribers, AT&T is the second largest mobile service provider in Mexico with an estimated 18% market share, behind America Movil's estimated 60%+ share. 75% of AT&T Mexico's subscribers are prepaids. Monthly churn rates, although declining, were 5.7% in 23Q2 or roughly six times higher than the U.S. wireless business.

In 23H1, AT&T Mexico's revenues grew by 23.5% to $1.85 billion. Subscribers increased by 4.8%, but average revenue per user rose 10.4% to $7.78 (per month). Estimated ARPU (including both service and equipment operating revenues) increased 17.5% to $14.24. A significant part of the increase was due to a 13.8% increase in the value of the Mexican peso vs. the dollar. Excluding currency, I estimate that there was a moderate improvement in the business from higher selling prices. Operating costs (as a percent of revenues) also declined.

Over the past 30 months, AT&T Mexico's operating income has improved nearly to breakeven and it has become EBITDA positive. Its 23H1 EBITDA margin was solid at 15.7%, but still only about one-third of U.S. Mobility's 23H2 EBITDA margin of 41.8%. Its return on average assets of 3.8% for 2022 (as measured by EBITDA-to-average total assets, the only official measure available) is likewise only about 40% of that of the Communications segment.

Table 4

AT&T Inc. (T)

Latin America Results – 2020-2023

($ mil.)

	12 Months 31-Dec-20	12 Months 31-Dec-21	12 Months 31-Dec-22	6 Months 30-Jun-22	6 Months 30-Jun-23
Operating revenue					
Service	1,656	1,834	2,162	1,024	1,226
Equipment	906	913	982	474	624
Mobility operating revenues	2,562	2,747	3,144	1,498	1,850
Percent growth		7.2%	14.5%	13.6%	23.5%
Operating expenses					
Operations and support	2,718	2,652	2,812	1,352	1,559
as % of revenues	106.1%	96.5%	89.4%	90.3%	84.3%
Depreciation & amortization	517	605	658	330	360
Total operating expenses	3,235	3,257	3,470	1,682	1,919
Operating income	(673)	(510)	(326)	(184)	(69)
Operating income margin	-26.2%	-18.6%	-10.4%	-12.3%	-3.7%
EBITDA	(156)	95	332	146	291
EBITDA margin	-6.1%	3.5%	10.6%	9.7%	15.7%

Source: AT&T's financial statements and earnings press releases.

The low returns are most likely the result of AT&T Mexico's low market share (relative to the market leader America Movil) and high concentration of prepaid customers. It is not clear therefore exactly how much improvement potential there is in the business. (The high percentage of lower margin prepaid subscribers suggests that the upside to profitability is probably limited.) It would seem prudent, therefore, for AT&T to seek to gain greater scale either in Mexico or in other parts of Latin America through mergers and acquisitions. Presumably, AT&T has retained Latin America as the name for the segment (rather than Mexico) because it had plans to grow the business. But its operations in the Caribbean and other parts of Latin America were sold Grupo Wertheim in 2021. It is not clear why Mexico was excluded from that sale. If the company does not have the capital to grow the business and there is no strategic rationale for keeping it, then the company should consider selling it, if indeed that is possible. As a guess, the business may be worth $3 billion or more (assuming an annual EBITDA run rate of $400 million).

Corporate Expenses and Operating Income. Corporate expenses for AT&T are still on the rise. In 23H1, they increased 11.0% from 22H1 to $1.48 billion, partially offsetting the gains in segment income. Even so, adjusted operating income rose 6.2% from $11.7 billion to $12.4 billion (reflecting a 100 bp increase in adjusted operating margin to 20.6%). The absence of 22H1's $1.2 billion of significant items (e.g. transaction costs, employee separation costs and impairments excluded in the determination of adjusted (non-GAAP) earnings), helped lift GAAP operating income by 18.3% from $10.5 billion to $12.4 billion in 23H1. Corporate expenses may remain high for a while as the company continues to pursue its cost cutting objectives, but they should decrease (as a percent of revenues) over time.

Cost and Debt Reduction. AT&T says that it has met its cost reduction target of $6 billion. It has therefore expanded the program, raising its target of $8 billion, which it expects to achieve with the next 3 years.

The company is seeking to improve its financial flexibility by reducing its debt burden. Most of its free cash flow after the payment of dividends will be devoted to reducing debt. It aims to reduce its ratio of net debt-to-adjusted EBITDA ratio from 3.1 at the end of 23Q2 to 2.5 times by mid-2025. Improved financial flexibility will also help raise the company's strategic flexibility.

The Uproar Over Lead-Clad Cables. In two articles[1] published in early July, the WSJ detailed numerous examples of telecom cables leaching lead into the ground, water and air that may pose a significant health hazard in many areas across the country. The major telecommunications companies have reportedly known about this issue for decades.

While the articles highlight specific instances of elevated lead levels in certain people and groups that were exposed, they did not attempt to extrapolate the results onto the U.S. population to quantify, for example, what percentage of the local, regional or national population has been or could be affected or the likely impact on the health of the population. Many of the cited examples are indeed troubling, but since there have been no apparent reports of widespread health problems associated with these cables for the many decades that they have been deployed, it is difficult to know how serious a problem this is and consequently what the remediation efforts should be.

On the 23Q2 earnings conference call, AT&T CEO John Stankey called for key industry players to collaborate with the EPA to address the issue. The Justice Dept. and EPA have recently directed AT&T and Verizon to provide relevant data on their efforts to date to assess the scope of the problem. AT&T has expanded its existing practice of testing employees involved with removal of lead-clad cables and added a voluntary testing program for employees who work with such cables. It has also halted a plan to remove lead cables in the Lake Tahoe area, opting instead to have the safety of those cables fully adjudicated. (This presumably would protect AT&T from an onslaught of litigation to remove cables even though they may be safe.)

In New York, Governor Hochul has directed certain state departments to investigate the presence of lead-clad cables and the potential public health risks associated with exposure to them. The state's regulator has issued requests to telecom operators seeking a full inventory of lead-clad cables within their service territories. More states or local governments may pursue similar investigations in the future.

New Street Research's Blair Levin, who previously served as Executive Director of the FCC's National Broadband Plan, has suggested[2] that as many as a dozen states may choose to use excess funding availability under the Federal government's $42.5 billion BEAD program to remediate lead-clad cables, after meeting their obligations to connect underserved locations.

AT&T asserts, based upon its own investigations and decades-long experience in working with lead-clad cables, that they do not pose a public health risk. Nevertheless, the WSJ's reporting

[1] https://www.wsj.com/articles/lead-cables-telecoms-att-toxic-5b34408b
https://www.wsj.com/articles/att-verizon-lead-cables-telecom-5e329f9

[2] https://www.fiercetelecom.com/telecom/lead-covered-cables-may-impact-bead-deployments

suggests that some additional effort may be required to remediate sagging cables or cover exposed cables to prevent them from leaching. This could include, in AT&T's case, ensuring that the many conduits that it abandoned in 2022 do not pose a lead safety hazard. There will be a cost associated with such an effort, perhaps measured in billions of dollars over an extended period, but based upon what I have learned so far, it seems that these costs will be manageable for AT&T within the ordinary course of business.

After the WSJ articles were published, the stocks of AT&T and other providers of wireline telecom services fell sharply. AT&T's stock fell 11.2% from July 13 (the date of the second WSJ article) to an intraday low of $13.43 on July 18 (three trading sessions later.) It has since bounced back to $14.45 on July 28, down a more modest 4.4% since July 13. Besides the WSJ articles, J.P. Morgan downgraded AT&T on July 14, which contributed to the sell-off.

Pensions. Approximately 506,000 AT&T retirees and dependents were eligible to receive retirement benefits in 2022. That compares with 160,700 active employees as of January 31, 2023. AT&T paid combined benefits of $7.1 billion in 2022, down from $7.2 billion in 2021.

At December 31, 2022, the combined unfunded status of AT&T's pension and postretirement benefits plans was $7.1 billion, compared with its $12.2 billion unfunded status in 2021. Most of the improvement was due to actuarial gains arising from the increase in the discount rate (in line with the increase in interest rates), which more than offset a 14% decline in the value of the funds' assets. The company also recorded a $2.4 billion reduction in its postretirement benefits obligation due to amendments to its health and welfare benefits programs.

In 2022, AT&T recorded a net pension and postretirement credit of $4.8 billion (included in other income). That was down sharply from $7.7 billion in 2022. With the increase in interest rates and other factors, pension credits and actuarial gains declined from an estimated $3.4 billion in 22H1 to $1.3 billion in 23H2 or by about $0.27 per share. Lower pension income is one of the headwinds facing AT&T in 2023.

In May, AT&T and State Street Global Advisors Trust Co., an independent fiduciary of the AT&T Pension Benefit Plan, transferred $8.05 billion of AT&T's defined benefit pension obligations to affiliates of Athene Holding Ltd. through a purchase of group annuity contracts. The transfer represented 18.8% of the pension plans projected benefit obligation at December 31, 2022. The company recognized a $363 million pension settlement gain at closing.

In April, AT&T repurchased all its Series A Cumulative Perpetual Preferred Membership Interests in AT&T Mobility II LLC. for $5.4 billion. Those interests had been held by AT&T's pension fund. The purchase was financed almost entirely through the issuance of $5.25 billion of nonconvertible cumulative preferred interests (Class A-2 and A-3) in another Mobility subsidiary, Telco LLC. Dividend rates on the preferreds issued and retired are nearly identical: 6.85% on the Telco preferreds and 7.00% on the Mobility preferreds. One difference, though, is the non-convertibility of the new preferreds, which will keep them out of the diluted EPS calculation, increasing diluted EPS by about $0.01 per quarter.

The Two Big Concerns: Cash Flow and Leverage. AT&T's stock is valued at less than 7 times forward GAAP earnings and less than 6 times forward non-GAAP earnings. Such low multiples - far below market averages – typically reflect concerns about the sustainability of future profits and cash flows. Also supporting this view, the stock's 7.7% dividend yield is five times that of the S&P 500 and more than twice the average yield on utility stocks. A very high yield trumpets concerns about a possible dividend cut.

Despite the worries exhibited in AT&T's stock price, its outstanding bonds display no similar concerns. AT&T's unsecured bonds are rated Baa2 and BBB. As shown on the cover page of this report, the yields on a selected sample of its bonds with maturities running from 2026-2053, currently range from 5.37% to 5.73%. Spreads over comparable maturity Treasury yields on those bonds range from 85 to 170. By comparison, the ICE BoA BBB U.S. Corporate Bond index currently has an average effective yield of 5.79% and an option-adjusted spread vs. Treasurys of 148 bp on July 28. Thus, AT&T bonds are trading in line with their Baa2/BBB rating. If there were concerns about a material decline in AT&T's profitability, I would expect to see higher yields and spreads on AT&T's bonds that would be more in line with Ba2/BB (non-investment grade) corporate bonds or lower.

The cause of AT&T's low equity valuation is also not immediately apparent from a review of AT&T's financial statements over the past three years. Yes, revenues and operating income have declined steadily over the past two years; but excluding the video business (which was sold), other businesses held-for-sale and certain significant items (i.e. the non-GAAP adjustments), segment revenues are up and operating income is down only modestly.

Those significant 2022 non-GAAP items included a $28.4 billion of goodwill impairment charge to write-down the value of its Business Wireline, Consumer Wireline and Mexico businesses. This was due to a higher weighted-average cost of capital, caused mostly by higher interest rates, cost inflation and secular declines in growth rates, mostly in Business Wireline growth rates, all of which reduced the net present values of future cash flows of those businesses. Given this year's increase in interest rates, AT&T might book another goodwill impairment charge this year that would most likely be smaller than 2022's. Besides that goodwill impairment charge, the company booked $1.4 billion of wireline conduit asset abandonment charges and $1.3 billion of restructuring and other impairment charges in 2022.

Also reflected in the low equity valuation multiples are the significant challenges that AT&T still faces in managing through the competitive dynamics in the Mobility business, the continuing declines in the legacy portions of the Business and Consumer Wireline businesses and growing the Fiber Broadband business in a maturing market. Even so, helped by cost cutting, the company is on track to meet its guidance for 2023 and, barring a significant slowdown in the economy, its financial performance should show further improvement in 2024.

Another key concern that has received special emphasis lately in the media is AT&T's leverage.[3] Although its outstanding debt and noncontrolling interests (mostly preferred stock of Mobility subsidiaries) is down from 2021 levels, its net debt-to-total capitalization[4] rose to 60% in 22Q4 and 23Q2, from 51.8% in 2021. Net debt-to-adjusted EBITDA also remains high at 3.6 times.

Prompted by a new accounting standard on supplier finance programs that became effective this year, AT&T has expanded its disclosures of certain financing practices, including its use of supplier financing programs (typically provided by banks), direct supplier financing (extended payment terms on purchases from suppliers) and vendor financing (extended payment terms

[3] https://www.wsj.com/articles/at-t-verizon-investors-have-more-than-lead-cables-to-worry-about

[4] I include noncontrolling interests and the liquidation value of preferred stock as debt in this calculation.

for capital expenditures), that are not recorded as debt on its balance sheet.[5] (They are included in "accounts payable and accrued liabilities" and also in "all other liabilities.") According to my calculations, these financing programs totaled $10.1 billion at 23Q2, compared with total debt outstanding of $143.3 billion.

Along with other unconventional financing techniques, such as the sale of accounts receivable, the issuance of subsidiary preferreds and the outstanding cumulative perpetual preferreds at the holding company (with total estimated liquidation value of $5.2 billion), it is apparent that AT&T's effective debt levels are above what appears on its balance sheet. Furthermore, the company does not disclose in its quarterly or annual filings its available liquidity (i.e. amounts that are available for borrowing under its commercial paper and bank credit facilities).

This unconventional financing is typically expensive. For example, in 23Q2, the company issued $2.0 billion of its Series B Cumulative Perpetual Preferred Membership Interests in Mobility II LLC, which pay cash distributions of 6.8% per annum. Presumably, there is little or no debt at Mobility II, so these preferreds are probably investment grade rated. The 6.8% distribution rate therefore seems both high and expensive, especially since (I believe) the distributions are not tax deductible. The company said that this issuance replaced a similar issue that was repaid in 22Q4. However, it is not clear why it did not pursue a less costly financing alternative.

Concerns about AT&T's leverage came to the fore after it reported 23Q1 financial results. For that quarter, the company reported free cash flow (according to its definition: cash flow from operating activities minus capital expenditures minus payment of vendor financing) of only $1 billion. For the quarter, that meant that its free cash flow dividend payout ratio was 0.5, as free cash flow covered only half the dividend payments of $2.0 billion. Since its guidance called for $16 billion in free cash flow for all of 2023, investors also questioned whether the company would be able to deliver and so its stock fell 10.4% on the day of the earnings announcement. Yet, management reaffirmed its full year guidance for free cash flow and all other metrics.

After 23Q1 earnings, AT&T's stock continued to decline, underperforming the broader market and its peer group. It bottomed in late May and then traded sideways until the WSJ lead-clad cable exposé. In all, AT&T's stock has fallen 21.5% in price YTD through July 28, much worse than the price gains of 19.3% in the S&P 500 and 44.8% in the S&P Communication Services sector index (which includes GOOGL and META).

After the 23Q1 earnings report, AT&T's CFO Pascal DesRoches presented a more detailed picture of the progression of free cash flow at a brokerage conference in June. He said that free cash flow would improve to $3.5-$4.0 billion in 23Q2 and then increase further in 23Q3 and 23Q4 as capital spending moved past its expected 23H1 peak.

In fact, AT&T reported free cash flow of $4.2 billion in 23Q2 and reaffirmed its full year free cash flow guidance of $16 billion. 23Q2 GAAP diluted earnings of $0.61 per share were $0.02 better than 22Q2. Non-GAAP EPS of $0.63 was $0.02 worse, but $0.03 above the consensus estimate. There were concerns about slowing net subscriber additions in both Mobility and fiber broadband, but that had been telegraphed by management well before the earnings

[5] https://www.ft.com/content/db78acfa-ba87-4daa-9c24-718d14cf4a95

announcement. Mobility net adds were hurt by the loss of 75,000 subscribers on a government account that the company decided to let go because its profitability was only breakeven.

Although the 2023 second quarter ended up right about where management said it would, AT&T's stock barely budged on the news. After having fallen nearly 26% since the disappointing first quarter results, I would have expected at least a modest rebound. Perhaps investors are still spooked by the lead-clad cable problem or maybe they still have doubts about whether the company can meet its guidance.

So let's recap: AT&T's stock has fallen 25.8% since it reported 23Q1 earnings. There were two evident catalysts for the decline: 23Q1's disappointing free cash flow and the WSJ report on lead-clad cables. 23Q2 results were better than expected and AT&T is more visibly on track to achieve its 2023 free cash flow objective of $16 billion as well as the rest of its guidance. At this time, the exact cause of the stock's inability to recover is unclear. The 23Q2 earnings report and conference call should have addressed most concerns about the company's ability to meet its 2023 guidance. Perhaps then, fears about lead-clad cabling are weighing on the stock or investors are still concerned about the company's leverage, including its "hidden" leverage.

As noted above, I believe that while the company may incur some additional costs associated with addressing lead-clad cabling, it does not appear to be a problem that by itself will lead to a significant diminution of the value of shareholders' interests. If investors are waiting to gain more confidence about this, then the stock may not recover in earnest until the EPA, the state of New York (or other state and local governments) or the courts render their decisions (assuming that they will be favorable for AT&T).

As for the leverage, hidden or otherwise, I believe that this is an issue to which investors should pay close attention going forward. Even so, I see nothing at this time (save for an external event, such as a sudden deterioration in economy) that suggests that AT&T will have difficulty in the intermediate term meeting its financial obligations. It continues to have access to the capital markets for commercial paper and other securities issuance. The bond market also shows little concern about AT&T's leverage at this time. Moody's and Standard & Poor's have completed their reviews of AT&T within the past 3-4 months without taking any action. That effectively affirms the company's Baa2/BBB credit ratings and maintains a stable outlook. (Both reviews were completed before the WSJ articles were published, however.)

Valuation. As noted, AT&T is valued at less than 7.0 times forward GAAP earnings and less than 6.0 times forward non-GAAP earnings. As some of the remaining uncertainty around lead cabling and the potential near-term impact of its leverage are resolved and assuming that the company remains on track to achieve its 2023 guidance, I believe that the stock will recover.

Under the circumstances, I believe that this will be a slow recovery process; but given the market's increasingly manic behavior, sentiment could change relatively quickly in which case the rebound in the stock price could be faster than I imagine.

Consequently, I have established what I believe is a conservative 12-month price target of $18.00 on the stock, which equates to a one-year forward multiple of about 8 times projected 2024 GAAP EPS of $2.23 and 7 times projected 2024 non-GAAP EPS of $2.51. From Friday's (7/28) closing price of $14.45, that represents a total potential return of 32%, including the stock's annual dividend of $1.11 and its current dividend yield of 7.7%.

Projections. My projections are almost entirely in line with management's guidance, as shown in the table below:

Table 5

Lark Research Projections vs. AT&T Management's Guidance

MODEL VS. GUIDANCE	GUIDANCE	PROJECTIONS
Wireless service revenue growth	>=4%	4.5%
Broadband revenue growth	>=5%	5.6%
Adjusted EBITDA growth	>=3%	6.2%
Capital investment	$24B	$24B
Free cash flow	>=$16B	$16B
Adjusted EPS	$2.35-$2.45	$2.45
Expected tax rate	23%-24%	23.1%

My projections for the rest of 2023 assume growth in Mobility subscribers (including postpaid) that is consistent with the slower 22Q2 trend, with further slowing in 2024. Likewise, I assume that net fiber broadband adds for 23H2 will be consistent with 23H1, with only a modest pickup in 2024. Non-fiber broadband declines are expected to continue at the recent historical pace.

Overall, I project that operating revenues will increase 0.3% in 2023 and 0.4% in 2024. The 2023 growth rate implies slower growth in 23H2 than what was reported for 23H1.

I project that operating margin (as reported and adjusted) will remain above 20% for the forecast period, higher than the recent historical average, reflecting the benefits of cost cutting initiatives, but below the operating margins reported for 23Q2.

My free cash flow projections are consistent with management's guidance, with positive free cash flow of $5.3 billion and $5.6 billion projected for 23Q3 and 23Q4, respectively. My projections imply that the free cash flow dividend payout ratio will improve from 2.0 in 23Q2 to 2.6 in 23Q3 and 2.7 in 23Q4. For the full years, I see a free cash flow dividend payout ratio of 2.0 times in 2023 and in 2024.

A key objective of the company is to reduce leverage, as measured by its net debt-to-adjusted EBITDA ratio. My projections show that ratio declining from 3.2 in 2022 to 2.9 in 2023 and then to 2.7 in 2024. This is consistent with the company's goal of 2.5 by mid-2025.

Table 6

AT&T Inc. (T)

Historical and Projected Consolidated Statements of Income: 2022-2024F

(in $ millions)	Historical 12 Months 31-Dec-22	Historical 3 Months 31-Mar-23	Historical 3 Months 30-Jun-23	Projected 3 Months 30-Sep-23	Projected 3 Months 31-Dec-23	Projected 12 Months 31-Dec-23	Projected 12 Months 31-Dec-24
Operating revenues							
Service	97,831	24,617	24,850	24,286	24,554	98,307	97,257
Equipment	22,910	5,522	5,067	6,071	6,139	22,799	24,314
Total operating revenues	120,741	30,139	29,917	30,357	30,693	121,106	121,571
Operating expenses							
Equipment	24,009	5,658	5,056	5,404	5,525	21,642	22,491
Other cost of revenues	26,839	6,673	6,771	6,861	6,906	27,211	26,867
Gross profit	69,893	17,808	18,090	18,093	18,262	72,253	72,213
Gross margin	57.9%	59.1%	60.5%	59.6%	59.5%	59.7%	59.4%
Selling, general and administrative	28,961	7,175	7,009	6,982	7,059	28,225	27,961
Asset impairments and abandonments	27,498	0	0	0	0	0	0
Depreciation and amortization	18,021	4,631	4,675	4,800	4,817	18,924	19,455
Total costs and expenses	74,480	11,806	11,684	11,783	11,877	47,149	47,416
Operating income	(4,587)	6,002	6,406	6,310	6,385	25,104	24,797
Operating margin	-3.8%	19.9%	21.4%	20.8%	20.8%	20.7%	20.4%
Interest expense	(6,108)	(1,708)	(1,608)	(1,939)	(1,929)	(7,185)	(7,237)
Equity in net income of affiliates	1,791	538	380	500	500	1,918	2,000
Other income	5,810	935	987	594	580	3,097	2,273
Income (loss) before income taxes	(3,094)	5,767	6,165	5,465	5,536	22,934	21,832
Income tax expense	(3,780)	(1,314)	(1,403)	(1,257)	(1,329)	(5,303)	(4,803)
Earnings (loss) from cont. operations	(6,874)	4,453	4,762	4,208	4,207	17,630	17,029
Earnings. from disc. operations	(181)	-	-	-	-	-	-
Net Income (Loss)	(7,055)	4,453	4,762	4,208	4,207	17,631	16,996
Less: Net inc. (loss) attrib. to n/c interests	(1,469)	(225)	(273)	(241)	(241)	(981)	(976)
Net income attributable to AT&T	(8,524)	4,228	4,489	3,966	3,966	16,651	16,053
Less: Preferred stock dividends	(203)	(52)	(52)	(85)	(85)	(274)	(339)
Net inc. attributable to common stock	(8,727)	4,176	4,437	3,882	3,881	16,377	15,714
Per-share amounts from cont. operations							
Basic EPS	($1.10)	$0.58	$0.61	$0.55	$0.55	$2.32	$2.23
Diluted EPS	($1.10)	$0.57	$0.61	$0.55	$0.55	$2.32	$2.23
Per-share amounts - disc. operations							
Basic EPS	($0.03)	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Diluted EPS	($0.02)	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Per-share amounts - net earnings							
Basic EPS	($1.13)	$0.58	$0.61	$0.55	$0.55	$2.32	$2.23
Diluted EPS	($1.13)	$0.57	$0.61	$0.55	$0.55	$2.32	$2.23
Non-GAAP EPS	$2.64	$0.60	$0.63	$0.59	$0.59	$2.45	$2.51
Weighted average shares outstanding							
Basic	7,166	7,168	7,180	7,058	7,050	7,050	7,050
Diluted	7,587	7,474	7,180	7,058	7,050	7,050	7,050

Source: AT&T financial statements and earnings press releases and Lark Research estimates and projections.

Table 7

AT&T Inc. (T)

Historical and Projected Consolidated Balance Sheets: 2022-2024F

(in $ millions)

	Historical 31-Dec-22	Historical 31-Mar-23	Historical 30-Jun-23	Projected 30-Sep-23	Projected 31-Dec-23	Projected 31-Dec-23	Projected 31-Dec-24
ASSETS							
Cash, cash equiv. & restricted cash	3,701	2,821	9,528	10,768	7,281	7,281	6,826
Receivables	11,466	10,214	9,304	8,770	8,867	8,867	8,510
Inventories	3,123	2,791	2,348	2,642	2,640	2,640	2,708
Prepaid and other current assets	14,818	14,077	15,492	14,656	13,646	13,646	13,408
CURRENT ASSETS	33,108	29,903	36,672	36,835	32,433	32,433	31,451
Property, plant and equipment	127,445	128,458	128,783	128,433	128,250	128,250	126,995
Goodwill	67,895	67,895	67,854	67,854	67,854	67,854	67,854
Licenses – Net	124,092	124,502	125,049	125,174	127,374	127,374	127,774
Other intangible assets - net	5,354	5,346	5,339	5,299	5,259	5,259	5,099
Inv. & advances to equity affiliates	3,533	2,810	2,779	2,935	3,091	3,091	3,735
Operating lease right-of-use assets	21,814	21,619	21,581	21,581	21,581	21,581	21,581
All other assets	19,612	20,340	20,396	20,058	19,979	19,979	19,577
TOTAL ASSETS	402,853	400,873	408,453	408,169	405,821	405,821	404,067
LIABILITIES AND EQUITY							
Short-term borrowings	7,467	13,757	15,268	11,216	8,635	8,635	4,508
Note payable to DIRECTV	130	0	0	0	0	0	0
Accounts payable	42,644	38,389	33,038	32,908	32,744	32,744	30,159
Adv. billings and customer deposits	3,918	3,922	3,833	3,889	4,092	4,092	4,425
Dividends payable	2,014	2,082	2,020	2,044	2,041	2,041	2,034
CURRENT LIABILITIES	56,173	58,150	54,159	50,057	47,512	47,512	41,126
Long-term borrowings	128,423	123,727	128,012	130,264	127,845	127,845	122,836
Deferred income taxes	57,032	57,294	57,972	59,041	60,170	60,170	64,253
Postemployment benefit obligation	7,260	7,060	6,696	6,526	6,356	6,356	5,676
Operating lease liabilities	18,659	18,413	18,311	18,311	18,311	18,311	18,311
All other liabilities	28,849	27,883	25,258	23,979	23,430	23,430	20,675
TOTAL LIABILITIES	296,396	292,527	290,408	288,177	283,624	283,624	272,877
Redeemable noncontrolling interests	0	0	1,970	1,970	1,970	1,970	1,970
Noncontrolling interests	8,957	8,950	14,172	14,413	14,655	14,655	15,631
Preferred stock liquidation value	5,120	5,120	5,120	5,120	5,120	5,120	5,120
Common equity	92,380	94,276	96,783	98,489	100,453	100,453	108,469
Total EQUITY	97,500	99,396	101,903	103,609	105,573	105,573	113,589
TOTAL LIABILITIES AND EQUITY	402,853	400,873	408,453	408,169	405,821	405,821	404,067
Common shares outstanding	7,166	7,168	7,180	7,058	7,050	7,050	7,050

Source: AT&T financial statements and earnings press releases and Lark Research estimates and projections.

Table 8

AT&T Inc. (T)

Historical and Projected Consolidated Statements of Cash Flows: 2022-2024F

(in $ millions)

	Historical 12 Months 31-Dec-22	Historical 3 Months 31-Mar-23	Historical 3 Months 30-Jun-23	Projected 3 Months 30-Sep-23	Projected 3 Months 31-Dec-23	Projected 12 Months 31-Dec-23	Projected 12 Months 31-Dec-24
CASH FLOWS - OPERATING ACTIVITIES							
Net income from continuing operations	(6,874)	4,453	4,762	4,208	4,207	17,630	16,996
Adjustments							
Depreciation and amortization	18,021	4,631	4,675	4,800	4,817	18,924	19,455
Provision for uncollectible accounts	1,865	477	452	486	491	1,906	1,945
Deferred income tax expense	2,975	529	1,307	1,068	1,129	4,034	4,075
Net (gain) loss on inv., net of impairments	381	(93)	(67)	(500)	(500)	(1,160)	(2,000)
Pension and OPEB expense (credit)	(3,237)	(670)	(671)	(670)	(670)	(2,681)	(2,680)
Actuarial (gain) loss on pension and OPEB	(1,999)	0	(74)	0	0	(74)	0
Asset impairments and abandonments	27,498	0	0	0	0	0	0
Receivables	727	620	722	48	(588)	802	(1,588)
Other current assets	(674)	364	742	524	969	2,598	(66)
Accounts payable and other accr. liab.	(1,109)	(3,409)	(2,360)	560	336	(4,873)	(1,885)
Equip. installment rec. and related sales	154	(243)	(59)	0	0	(302)	0
Def. cust. contr. acq. and fulfillm. costs	(947)	(22)	56	61	123	217	638
Postretirement claims and contributions	(823)	(89)	(467)	(170)	(170)	(896)	(680)
All other operating activities	(146)	130	904	(96)	422	1,359	651
Cash from oper. act. - cont. oper.	35,812	6,678	9,922	10,320	10,567	37,486	34,901
CASH FLOWS - INVESTING ACTIVITIES							
Capital expenditures	(19,626)	(4,335)	(4,270)	(4,550)	(4,710)	(17,865)	(18,500)
Acquisitions, net of cash acquired	(10,200)	(291)	(224)	0	(2,100)	(2,615)	0
Dispositions of PP&E	199	15	1	15	15	46	60
DIRECTV distr. in exc. of cum. eq. in earn.	2,649	774	200	300	300	1,574	1,200
(Purch.) sales of sec. & inv. - net	0	0	(1,056)	0	0	(1,056)	0
All other investing activities	79	19	(74)	44	44	33	156
Cash from inv. act. - cont. oper.	(26,899)	(3,818)	(5,423)	(4,191)	(6,451)	(19,883)	(17,084)
CASH FLOWS - FINANCING ACTIVITIES							
Net inc. (dec.) in short-term borrowings	(14,909)	3,091	534	(4,052)	(2,581)	(3,008)	(4,127)
Net inc. (dec.) in long-term borrowings	(22,139)	(2,579)	4,603	2,252	(2,419)	1,857	(5,009)
Note payable to DIRECTV	(1,211)	(130)	0	0	0	(130)	0
Payment of vendor financing	(4,697)	(2,113)	(1,643)	(800)	(600)	(5,156)	(1,100)
Net purchase of treasury stock	(862)	(185)	(1)	(218)	39	(365)	129
Net Pref. interests in subsidiaries	(2,665)	0	1,818	0	0	1,818	0
Dividend payments	(9,859)	(2,014)	(2,083)	(2,044)	(2,041)	(8,182)	(8,159)
All other financing activities	(3,222)	219	(1,047)	(1)	0	(829)	(7)
Cash from fin. act. - cont. oper.	(59,564)	(3,711)	2,181	(4,863)	(7,602)	(13,994)	(18,266)
Discontinued operations	33,128	0	0	0	0	0	0
INC. (DEC.) IN CASH	(17,523)	(851)	6,680	1,266	(3,487)	3,608	(456)
Beginning cash, cash equiv. and restr. cash	21,316	3,793	2,942	9,622	10,888	3,793	7,401
Ending cash, cash equiv. and restr. cash	3,793	2,942	9,622	10,888	7,401	7,401	6,946

Source: AT&T financial statements and earnings press releases and Lark Research estimates and projections.

Table 9

AT&T Inc. (T)

Historical and Projected Segment Results: 2022-2024F

(in $ millions)

	Historical 12 Months 31-Dec-22	Historical 3 Months 31-Mar-23	Historical 3 Months 30-Jun-23	Projected 3 Months 30-Sep-23	Projected 3 Months 31-Dec-23	Projected 12 Months 31-Dec-23	Projected 12 Months 31-Dec-24
Operating revenues							
Communications							
Mobility	81,780	20,582	20,315	20,836	21,230	82,964	84,638
Business wireline	22,538	5,331	5,279	5,177	5,076	20,863	19,343
Consumer wireline	12,749	3,239	3,251	3,267	3,293	13,050	13,046
Total communications	117,067	29,152	28,845	29,280	29,600	116,877	117,026
Latin America	3,144	883	967	992	1,018	3,860	4,345
Total segment revenues	120,211	30,035	29,812	30,272	30,618	120,737	121,371
Corporate and Other	530	104	105	85	75	369	200
Total operating revenues	120,741	30,139	29,917	30,357	30,693	121,106	121,571
Operations and support expenses	107,307	19,506	18,836	19,246	19,490	77,078	77,319
Segment EBITDA							
Communications							
Mobility	32,726	8,369	8,736	8,874	9,007	34,986	34,802
Business wireline	8,566	1,708	1,729	1,667	1,645	6,749	6,306
Consumer wireline	4,496	955	1,025	1,029	1,037	4,046	4,370
Total communications	45,788	11,032	11,490	11,570	11,689	45,781	45,478
Latin America	332	145	146	119	122	532	521
Segment EBITDA	46,120	11,177	11,636	11,689	11,811	46,313	45,999
Corporate & Other	(32,686)	(544)	(555)	(579)	(608)	(2,286)	(1,747)
Total EBITDA	13,434	10,633	11,081	11,111	11,203	44,028	44,252
Depreciation and amortization	18,021	4,631	4,675	4,800	4,817	18,924	19,455
Operating income	(4,587)	6,002	6,406	6,310	6,385	25,104	24,797
Interest expense	(6,108)	(1,708)	(1,608)	(1,939)	(1,929)	(7,185)	(7,237)
Equity in net income of affiliates	1,791	538	380	500	500	1,918	2,000
Other income	5,810	935	987	595	581	3,097	2,273
Income (loss) before income taxes	(3,094)	5,767	6,165	5,466	5,537	22,934	21,832

Source: AT&T financial statements and earnings press releases and Lark Research estimates and projections.

Table 10

AT&T Inc. (T)

Key Metrics: 2022-2024F

(in $ millions, except ratios)

	Historical 12 Months 31-Dec-22	Historical 3 Months 31-Mar-23	Historical 3 Months 30-Jun-23	Projected 3 Months 30-Sep-23	Projected 3 Months 31-Dec-23	Projected 12 Months 31-Dec-23	Projected 12 Months 31-Dec-24
Free cash flow (as defined by AT&T)							
Cash from operating activities	35,812	6,678	9,922	10,320	10,567	37,486	34,901
Add: DIRECTV distr. classified as inv. act.	2,649	774	200	300	300	1,574	1,200
Less: capital expenditures	(19,626)	(4,335)	(4,270)	(4,550)	(4,710)	(17,865)	(18,500)
Less: vendor financing	(4,697)	(2,113)	(1,643)	(800)	(600)	(5,156)	(1,100)
Free cash flow	14,138	1,004	4,209	5,270	5,557	16,039	16,501
Dividends paid	9,859	2,014	2,083	2,044	2,041	8,182	8,159
Free cash flow dividend payout ratio	1.4	0.5	2.0	2.6	2.7	2.0	2.0
Net debt-to-adjusted EBITDA							
Total debt	135,890	137,484	143,280	141,480	136,480	136,480	127,344
Less cash and cash equivalents	(3,701)	(2,821)	(9,528)	(10,768)	(7,281)	(7,281)	(6,826)
Net debt	132,189	134,663	133,752	130,712	129,199	129,199	120,518
Adjusted EBITDA (TTM)	41,465	41,864	42,587	43,014	44,016	44,374	44,345
Net debt-to-adjusted EBITDA ratio	3.2	3.2	3.1	3.0	2.9	2.9	2.7
Total debt	135,890	137,484	143,280	141,480	136,480	136,480	127,344
Noncontrolling interests	8,957	8,950	14,172	14,413	14,655	14,655	15,631
Preferred stock liquidation value	5,120	5,120	5,120	5,120	5,120	5,120	5,120
Common equity	92,380	94,276	96,783	98,489	100,453	100,453	108,469
Total capitalization	242,347	245,830	259,355	259,502	256,708	256,708	256,564
Debt-to-total capitalization ratio	56.1%	55.9%	55.2%	54.5%	53.2%	53.2%	49.6%
Debt plus NCI plus pref. stock-to-total capital	61.9%	61.6%	62.7%	62.0%	60.9%	60.9%	57.7%
Debt plus supplier financing							
Total debt	135,890	137,484	143,280	141,480	136,480	136,480	127,344
Supplier financing programs	2,869	2,557	3,007	2,200	2,000	2,000	1,800
Direct supplier financing	5,486	5,129	3,539	4,800	4,600	4,400	4,200
Vendor financing	6,147	5,003	3,587	2,787	2,187	1,687	1,087
Total debt and supplier financing	150,392	150,173	153,413	151,267	145,267	144,567	134,431
Gross margin	57.9%	59.1%	60.5%	59.6%	59.5%	59.7%	59.4%
SG&A expense ratio	24.0%	23.8%	23.4%	23.0%	23.0%	23.3%	23.0%
Operating margin	-3.8%	19.9%	21.4%	20.8%	20.8%	20.7%	20.4%
EBITDA margin	11.1%	35.3%	37.0%	36.6%	36.5%	36.4%	36.4%
Adjusted EBITDA margin	34.3%	35.1%	36.9%	36.7%	36.6%	36.6%	36.5%
Net income / revenues	-7.2%	13.9%	14.8%	12.8%	12.6%	13.5%	12.9%
Revenues / avg. total assets	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Avg. total assets / avg. total equity	4.0	4.3	4.2	4.2	4.1	4.1	3.8
Return on equity	-8.3%	17.9%	18.6%	15.9%	15.6%	16.5%	14.6%
EBITDA	13,434	10,633	11,081	11,111	11,203	44,028	44,252
Interest incurred	7,402	1,980	1,871	2,089	2,039	7,980	7,737
Interest coverage	1.8	5.4	5.9	5.3	5.5	5.5	5.7

Source: AT&T financial statements and earnings press releases and Lark Research estimates and projections.

The original report (dated July 31, 2023) was revised to correct an error in the calculation of tangible book value per share. Previously, the report showed a value of $10.21. The corrected value, as shown on page one of this report is $3.29. My calculation of tangible book value excludes goodwill and other intangible assets only. I view licenses as a tangible asset.

Conflicts of Interest Disclosure:

The author has no position in the publicly traded securities of AT&T Inc. (T).

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