HILLIARD LYONS

Telecommunications
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COMPANY UPDATE / PRICE TARGET CHANGE / ESTIMATE CHANGE

Key Metrics

T - NYSE (Price as of 1/31/18)		$37.45
Price Target		$43.00
52-Week Range		$32.55 - $41.03
Shares Outstanding (mm)		6,183.0
Market Cap. ($mm)		$231,553
3-Mo. Average Daily Volume		33,838,000
Institutional Ownership		63.0%
Debt/Total Capital (12/31)		53.6%
ROE (ttm)		11.7%
Book Value/Share		$19.83
Price/Book Value		1.9x
Dividend Yield	$2.00	5.3%
LTM EBITDA Margin		25.4%

EPS FY 12/31

	2016	Prior 2017E	2017	Prior 2018E	Curr. 2018E
1Q					
2Q					
3Q					
4Q					
Year	$2.84		$3.05	$2.97	$3.50
P/E	13.2x		12.3x		10.7x

Revenue ($mm)

	2016	Prior 2017E	2017	Prior 2018E	Curr. 2018E
1Q					
2Q					
3Q					
4Q					
Year	$163,800		$160,546		$163,725

Company Description: *AT&T is one of the world's largest providers of pay TV. Additionally, AT&T has more than 156 million wireless subscribers and connections in the U.S. and Mexico; offers 4G LTE mobile coverage to nearly 310 million people in the U.S.; covers 57 million U.S. customer locations with high-speed Internet; and has nearly 16 million subscribers to its high-speed Internet service.*

AT&T

T -- NYSE – Buy -- 2

Company reports solid fourth quarter results; 2018 to benefit significantly from tax reform

Investment Highlights

- **AT&T reported fourth quarter adjusted earnings of $0.78 per share, which benefitted by $0.13 from lower taxes.** Without the positive impact, earnings would have been $0.65 per share and in line with expectations. Fourth quarter revenue of $41.7 billion was above the consensus estimate of $41.2 billion. This is significant, in our view, as more often than not in recent years T's revenues have come up short of expectations. For the year, T earned $3.05 per share compared to $2.84 per share in 2016, a gain of 7.4%. Earnings would have still been higher in 2017 even without the benefit of the $0.13 per share fourth quarter positive tax impact. Total 2018 revenues were $160.5 billion versus $163.8 billion in 2016, a decline of 2.0%. The company's total operating margin increased in 2017 to 19.8% from 19.4% in 2016.
- **Wireless additions showed renewed strength.** The company added 329,000 postpaid wireless customers in the fourth quarter. This marked the company's best quarterly performance in several years and was well above expectations of a loss of 30,000 customers. In addition, the company posted its best-ever 4Q postpaid churn rate of 0.89%.
- **Management introduces 2018 guidance.** T expects earnings of $3.50 per share in 2018. Earnings are expected to benefit by $0.45 per share from tax reform. Free cash flow is anticipated to be about $21 billion. Capex is expected to total $25 billion.
- **We maintain our Buy rating and raise our price target to $43.** While the telecom sector remains intensely competitive, we believe the stock appears attractive on both a valuation and yield basis. The stock trades at just 10.7x estimated 2018 earnings while offering an attractive 5.3% dividend yield. We believe T has merit for income oriented investors seeking modest capital appreciation potential.

Note Important Disclosures on Pages 3-4.
Note Analyst Certification on Page 3.

Fourth Quarter and Full-Year Results

AT&T earned $0.78 per share in the fourth quarter versus $0.66 in 2016's fourth quarter. These results included a $0.13 per share benefit from tax reform. Excluding this, earnings were $0.65 per share and in line with expectations. Total revenues were $41.7 billion compared to $41.8 billion in 2016's fourth quarter. However, revenues were above the consensus estimate of $41.2 billion. This is noteworthy, in our view, as the company often reports quarterly revenue that falls below expectations. Perhaps the most significant factor during the fourth quarter was a resumption of wireless subscriber growth. The company added 329,000 postpaid wireless customers in the period. This marked the company's best performance in several years and was well above the consensus expectation of a loss of 30,000. This was a positive and encouraging surprise. Entertainment Group revenue declined from $13.2 to $12.7 billion in the fourth quarter. Legacy declines were partially offset by strength in DIRECTV, which added 368,000 consumers. T's Business Solutions and International segments saw their revenues increase by 2% and 16%, respectively. For the year, AT&T posted earnings of $3.05 per share versus $2.84 per share in 2016. Without the tax benefit, the earnings comparison would have been $2.92 per share versus $2.84 per share. For the year, total revenues declined by 2% from $163 billion to $160 billion.

Outlook

Management expects 2018 earnings of $3.50 per share. This guidance reflects a $0.45 per share benefit of tax reform. Free cash flow is expected to be about $21 billion this year. Capital spending is anticipated to approach $25 billion. AT&T indicated its biggest priority in 2018 is to complete its proposed acquisition of Time Warner. The company's court case goes to trial on March 19. A final ruling on the matter is not expected until May. We don't pretend to have enough legal knowledge to venture a guess as to the final outcome. The companies hope to prove that this is a vertical acquisition and does not harm competition. The company's earnings guidance excludes the potential acquisition of Time Warner. Our revised $3.50 per share estimate reflects new company guidance. While earnings may benefit by $0.45 per share from lower taxes this year, the telecom industry remains intensely competitive.

Rating

We maintain our Buy rating on AT&T. More than anything else, the stock appears attractive on both a valuation and yield basis. The stock trades at just 10.7x estimated 2018 earnings of $3.50 per share. Moreover, the stock carries an appealing 5.3% dividend yield. We believe the company has a solid fundamental outlook and could potentially benefit should its legal efforts to acquire Time Warner prove successful. We continue to view T as a suitable holding for income oriented investors seeking modest capital appreciation.

Valuation

We are raising our price target by $4 to $43 to reflect the company's greater profitability following the passage of tax reform. In recent years the stock has traded between 12x and 16x forward earnings. At a price of $43 the stock would be trading at 12.3x estimated 2018 earnings and toward the lower end of its P/E multiple range. We believe a multiple toward the low end of this range is justified due to the continued pressure on revenues. Our revised price target implies a potential total one year return of 20%.

Suitability

Our suitability rating for AT&T is a 2. While the company operates in a very competitive environment, its earnings tend to be stable. Moreover, the company generates large cash flows which support its generous dividend payout. Dividends have been increased for 34 consecutive years. We regard AT&T as an appropriate holding for conservative investors seeking income.

Risks & Considerations

There are a variety of risks that could negatively impact the stock reaching our price target. There is near-term risk that the company could lose its legal case with the government in its attempt to acquire Time

Warner. Moreover, even if the transaction is approved, there could be integration challenges associated with a business that AT&T has relatively little experience in. The company continues to face intense competition from Verizon, Sprint, and T-Mobile, and we expect this trend to continue for the foreseeable future. In addition, the wireless industry is mature, offering less growth potential than in years past. We also note the company's wireline segment remains under pressure, particularly its business segments. Also, the company's satellite TV business could be negatively impacted by changing consumer trends. Higher inflation and higher interest rates could have a negative effect on T's stock price. Finally, there remains Federal regulatory risk.

Prices of other stocks mentioned: Time Warner (TWX-$95.35), Verizon (VZ-$54.07), Sprint (S-$5.33) and T-Mobile (TMUS-$65.10).

Additional information is available upon request.

Analyst Certification

I, David B. Burks, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons acted as a manager or co-manager of an offering of securities of AT&T in the past 12 months.

Hilliard Lyons has received investment banking compensation from AT&T in the past 12 months.

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	31	28%	10%	90%
Hold/Neutral	75	67%	9%	91%
Sell	6	5%	0%	100%

As of 8 January 2018

Other Disclosures

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