Telecommunications
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COMPANY UPDATE / PRICE TARGET CHANGE / ESTIMATE CHANGE

Key Metrics

T - NYSE (Price as of 4/25/17)		$39.94
Price Target		$43.00
52-Week Range		$43.89 - $36.10
Shares Outstanding (mm)		6,166.0
Market Cap. ($mm)		$246,270
3-Mo. Average Daily Volume		18,852,000
Institutional Ownership		63.0%
Debt/Total Capital (3/31)		51.6%
ROE (ttm)		11.9%
Book Value/Share		$19.83
Price/Book Value		2.0x
Dividend Yield	$1.96	4.9%
LTM EBITDA Margin		25.7%

EPS FY 12/31

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q					
2Q					
3Q					
4Q					
Year	$2.84	$2.96	$2.94		$3.04
P/E	14.1x		13.6x		13.1x

Revenue ($mm)

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q					
2Q					
3Q					
4Q					
Year	$163,800		$162,500		$164,500

Company Description: *AT&T is one of the world's largest providers of pay TV. Additionally, AT&T has more than 132 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 mixed first quarter results but reaffirms 2017 EPS guidance; maintain Buy rating

Investment Highlights

- **AT&T reported first quarter earnings of $0.74 per share versus $0.72 per share in 2016's first quarter, and in line with expectations.** However, revenues of $39.4 billion were well below the consensus of $40.5 billion. Revenues declined by 2.9% on a year-over-year basis. The weakness in revenues was due to an extremely competitive telecom environment, magnified by the introduction of unlimited data plans by T's competitors. There was also a record low number of postpaid phone upgrades as consumers held onto their existing phones longer. Yet despite the revenue pressure the company was able to grow operating income to $8.2 from $8.1 billion a year ago through cost cutting measures. T's operating income margin was 20.7%, up from 19.9% in last year's first quarter.
- **Management updated 2017 guidance.** AT&T is no longer providing revenue guidance primarily due to the unpredictability of wireless handset sales. T had previously expected revenue growth in the low-single digits. AT&T did reaffirm its view of earnings per share growth in the mid-single digit range for this year. T also expects an expansion in its adjusted operating margin this year. Capital expenditures are estimated to be in the $22 billion range. Free cash flow is expected to be in the $18 billion range.
- **We maintain our Buy rating on AT&T but are trimming our price target by $1 to $43 to reflect the difficult operating environment.** We expect revenue pressures to persist throughout the year. However, we are keeping our Buy rating due to the company's valuation and yield. The stock trades at what we still feel is a reasonable valuation of 13.6x estimated 2017 earnings. In addition, T offers an attractive 4.9% dividend yield. Thus, we continue to believe T still has merit for income oriented investors. Our revised price target implies a potential total return of 12.5%.

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

First Quarter Results

T's first quarter results were mixed. The company earned $0.74 per share versus $0.72 per share as expected, and in line with expectations. While only a small gain, the increase seems more impressive in light of the company's revenue shortfall. Revenues totaled $39.3 billion compared to $40.5 billion in 2016's first quarter, a decline of 2.9%. Revenues were over $1 billion less than anticipated. The company experienced a decline in both service and wireless revenue in the first quarter. The intense competitive environment clearly had a negative impact on T's results. Conditions were made even worse than usual as a result of the introduction of unlimited data plans by the company's peers. AT&T responded with a plan of its own but admitted during its earnings call it had been a "little slow" to respond. During the quarter the company had 348,000 postpaid wireless losses.

Despite the pressure on wireless revenue, wireless margins held up well in the first quarter. T experienced a record EBITDA (earnings before interest, taxes, depreciation and amortization) margin of 41.8% compared to 40.8% in last year's first quarter. While postpaid churn of 1.12% was higher than the consensus estimate of 1.09%, some of the pressure came from tablets. Postpaid phone churn was a solid 0.90% in the period. AT&T's other segments also posted mixed results. T's Entertainment Group saw a modest decline in both revenue and margins. T's Business Solutions unit saw its revenues decline by over 4% although margins actually expanded. International revenues rose to $1.9 billion from $1.7 billion, led by gains in Mexico and Latin America. Despite the revenue headwinds T's overall operating income rose to $8.2 billion from $8.1 billion in 2016's first quarter. Operating income margin climbed to 20.7% from 19.9% in the prior year period as T's emphasis on cost cutting proved beneficial. Cash flow from operations totaled $9.2 billion versus $7.9 billion in 2016's first quarter.

Outlook

Management updated its 2017 guidance. While the company had previously expected revenue growth in the low-single digits this year, AT&T is no longer providing consolidated revenue guidance primarily due to the unpredictability of wireless handset sales. With the extremely competitive wireless industry showing no signs of easing, we now expect a modest decline in revenues for the year. However, the company did reaffirm the rest of its previous guidance. T anticipates earnings per share growth to be in the mid-single digit range. AT&T also expects its operating margin to expand again this year. Capital expenditures are projected to be in the $22 billion range versus last year's $22.4 billion. Free cash flow is anticipated to be approximately $18 billion compared to $16.9 billion in 2016. We are trimming our 2017 earnings per share estimate by $0.02 to $2.94 per share to reflect revenue pressures. Our initial 2018 EPS estimate is $3.04. Also, management believes the approval process associated with its proposed acquisition of Time Warner is moving forward as expected. The European Commission has approved the transaction and the Department of Justice is now reviewing it. Because there are no license transfers involved, the company doesn't expect the Federal Communications Commission to review it. T expects the deal to be approved by the end of the year.

Rating

We maintain our Buy rating on AT&T despite the first quarter's revenue shortfall. We are encouraged the company continues to expect modest earnings growth this year. Yet, our primary interest in the name remains its attractive, nearly 5% dividend yield. We believe the dividend is secure and expect the company to raise it for a 34th consecutive year late in 2017. Also, the stock trades at what we believe is a reasonable valuation at 13.6x estimated 2017 earnings. As mentioned before, we do not consider AT&T a "growth story" per se, but rather an income vehicle which offers some modest capital appreciation potential. After performing strongly in 2016, the stock is off 6% year-to-date. Yet we believe if the company can deliver ongoing modest earnings growth the stock can trend higher. Longer term, the acquisition of Time Warner could prove to be a potential positive as it could add growth in earnings as well as diversify revenues from the mature and extremely competitive wireless telecom market. In our view, AT&T remains a solid holding for conservative income oriented investors seeking modest capital appreciation.

Valuation

We are lowering our price target by $1 to $43 to reflect the ongoing extremely competitive telecom environment. In recent years the stock has traded between 12x and 16x forward earnings. At a price of $43 the stock would be trading at 14.1x estimated 2018 earnings and near the midpoint of its P/E multiple range. Our revised price target implies a potential total one year return of 12.5%.

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 increased for 33 consecutive years and we expect this trend to continue. 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 operational risk associated with the integration of the 2015 acquisition of DIRECTV asset. There is also risk associated with DIRECTV should TV subscriber rates continue to decline. From a macro perspective, should the economy continue to grow at a slow pace both the company and the industry could continue to be negatively impacted. The company also 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 a maturing one, offering less growth potential than in years past. We also note the company's wireline segment remains under pressure, particularly its business segments. Higher inflation and higher interest rates could also have a negative effect on T's stock price. Finally, there remains Federal regulatory risk.

Prices of other stocks mentioned: Time Warner (TWX-$100.04), Verizon (VZ-$46.70), Sprint (S-$8.95) and T-Mobile (TMUS-$67.35).

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' 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	36	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

Other Disclosures

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