

Executive Summary: AT&T, based in Dallas, TX, is the largest provider of local and long distance telephone services in the United States. The company is divided into four divisions: AT&T Wireline (traditional voice and data landline service), Wireless, Advertising and Publishing and Other (includes the business integration software subsidiary). Revenues in 2008 were approximately \$123 billion dollars, an increase of 4.3% over 2007. AT&T Wireless is the nation's second largest carrier by sales and subscriptions, accounting for over 77 million customers and \$69.8 billion dollars of revenue. Within AT&T the Wireless division represents the largest area of growth, compensating for customers abandoning traditional Wireline telephone service. AT&T landed a major coup in 2007 when it signed a deal with Apple to be the exclusive U.S. carrier for the iPhone. Not only did AT&T add new customers, it added more profitable customers. AT&T reports that an iPhone customer's average revenue per user (ARPU) is \$105 per month versus \$60 for non-iPhone customers. AT&T's corporate strategy for securing these profitable customers is to align itself with innovative technology, such as the iPhone, and pay a subsidy of \$325 to Apple to make the iPhone more affordable for mainstream America, its target market. AT&T recoups the subsidy by locking iPhone customers into a two-year contract averaging \$100 per month and maintaining this customer base through an exclusive contract with Apple.

Problem Statement: Despite attracting and capturing high revenue subscribers, AT&T is experiencing high customer dissatisfaction due to congested wireless networks. The greatest threat to AT&T Wireless is that iPhone customers will defect in droves if and when AT&T loses its exclusivity contract with Apple. Our analysis will focus on the root of this issue and provide marketing, strategic, operational and financial recommendations for AT&T Wireless. Our goal is to ensure AT&T drives long-term loyalty as opposed to operating on short-term borrowed brand equity from Apple.

Overview of Mobile Telecommunications Marketing: U.S. advertising spending by wireless carriers exceeded \$3.6 billion in 2008 according to *Brandweek's* "Super Brands" ranking. Market leaders Verizon Wireless and AT&T Wireless accounted for more than half of industry advertising, spending \$1.3 billion and \$1.2 billion, respectively. To put this in perspective, AT&T and Verizon outspent top brands such as McDonald's, Walt Disney, and Home Depot in an effort to differentiate their services in what is essentially a commoditized industry. Wireless providers have typically advertised based on functional benefits such as the quality of their networks, pricing, voice and data plans, and number of user minutes. In particular, both AT&T and Verizon tout the reliability and strength of their wireless networks through memorable slogans. Verizon is well known for its "Can you hear me now" slogan while AT&T touts "More bars in more places". Despite marketing based on

functional benefits, the product (wireless phone service) is essentially becoming more and more undifferentiated. As a result, AT&T and Verizon devote billions of dollars to build brand recognition with consumers on an emotional level.

Key Issues & Analysis (SWOT)

- **(S) AT&T-Apple iPhone Relationship:** AT&T's primary competitive advantage within the wireless industry comes from its exclusivity deal with Apple to sell the iPhone. Within the first six months of the iPhone launch in 2007, AT&T activated 4.3 million iPhone 3Gs – 40% of these customers were new to AT&T. Moreover, in 2008 AT&T added more wireless subscribers, led the industry in data services growth, and had twice as many smartphones than any other carrier in 2008. The exclusivity deal not only increased customer acquisition, but also attracted higher revenue customers – those using smartphones for data and voice coverage.
- **(W) Poor wireless infrastructure/ customer satisfaction:** While AT&T's partnership with Apple has added millions of new, high revenue users, it has been to the detriment of AT&T's broadband network. According to Broadpoint Amtech, 4% of AT&T's wireless customers are iPhone users. However they utilize roughly 40% of the network's bandwidth. iPhone users, for example, suffer from dropped calls and unreliable wireless coverage, resulting in low customer satisfaction. Compounding this issue is that about 40% of iPhone users switched from a different carrier solely to buy the Apple iPhone on AT&T's network. As a result, these customers are more likely to be dissatisfied and voice their discontent on online forums. Suddenly, AT&T has a weakness that has literally gone viral.
- **(O) AT&T's positioning in the AT&T/Apple relationship:** Through innovative technology, Apple has effectively established itself as the more valuable brand. In fact, respondents to a *Consumer Reports* survey revealed an interesting insight – despite AT&T's network mishaps, 98% of the iPhone users would “definitely” or “probably” buy the phone again. Even though AT&T is making the device more affordable by subsidizing each device by at least \$325, the company does not market this goodwill to its customers. As a result, only Apple enjoys the perceived value effects while AT&T is associated with dropped calls, a hard-to-access 3G network, and high fees. Moving forward, AT&T needs to demonstrate itself as a reliable technology partner and not just “the phone company”.
- **(T) Losing iPhone exclusivity:** According to Broadpoint Amtech and other telecommunications experts, the Apple – AT&T exclusivity deal is expected to end mid-2010. Should this occur, we foresee significant downside to AT&T's

wireless and data sales. As we mentioned, 4.3 million users joined AT&T after the launch of the iPhone. Industry experts believe a substantial portion of unsatisfied customers will move their business to a rival carrier if given the chance. Losing the exclusivity deal will negatively impact AT&T in several ways including, (1) loss of strong incremental growth rates, (2) reduction in high revenue iPhone customers, (3) and loss of brand cache through losing the exclusive relationship with an innovator such as Apple.

Surviving on borrowed brand equity: Customers all over the country have complained about dropped calls and the inability to connect to the 3G network, yet AT&T has not admitted any problems. When questioned about potential problems of the network being overburdened by iPhone users, an AT&T spokesman recited the company line: “We have a strong, high-quality mobile broadband network. It is the nation’s fastest 3G network, now in 350 major metropolitan areas.” AT&T states that “the surest indication of customer satisfaction is churn, and ours is at record-low levels (1.7%). Our own internal data suggests that our iPhone customers are very satisfied with AT&T.” But churn rates can be a misleading indicator. AT&T is the only U.S. wireless operator offering the iPhone. Once the exclusivity deal ends, dissatisfied customers may leave AT&T for another carrier. So, the question really becomes, how long can AT&T survive on borrowed brand equity?

AT&T’s 3G network issues: Because of the overwhelming acceptance of the iPhone and the high level of bandwidth the device consumes, AT&T’s network is congested – forcing dropped calls and customer backlash. *Consumer Reports* recently released the latest mobile telecommunications survey that highlights AT&T’s woes. AT&T has the lowest level of customer satisfaction among major wireless carriers in the U.S., receiving below-average marks for voice-quality and overall customer satisfaction. Verizon received above average marks while T-Mobile and Sprint both received average marks. The timing of this report couldn’t be worse for AT&T, as Verizon just launched a television campaign attacking AT&T’s 3G network. The ads, titled “There’s a Map for That”, show AT&T users struggling to use applications while Verizon customers happily stream videos. The ads then show maps for the 3G coverage for each carrier, with Verizon’s map shown as much larger. AT&T filed a lawsuit against Verizon Wireless, asking for a temporary restraining order against the campaign. AT&T argues that the 3G coverage maps that Verizon is using are misleading. But a new Verizon ad campaign is not AT&T’s only concern. Powerful social networks have changed the game for companies who are the target of negative customer sentiment.

Today's online communities allow customers to share negative experiences with a worldwide audience. Below is a recent excerpt from a blog:

“Hey AT&T, \$#@! YOU, I'm not paying you over \$140/month to hear your excuses for not upgrading your crappy network!”

AT&T must listen to their customers and address these complaints head on. We all know that satisfaction → loyalty → profits, so AT&T must ensure their customers' satisfaction to ensure future profitability.

What is AT&T currently doing to fix their network issues?: Regardless of AT&T's repeated denials regarding their 3G network's inefficiencies, they are taking some steps to improve it. AT&T has created an iPhone application that allows users to report specific geographic areas with poor service. AT&T also spent over \$17 billion in 2009 to double the capacity of its 3G network through software enhancements. They are also increasing the downlink capacity on their high-speed packet access (HSPA) from 3.6 megabits per second to 7.2 through software upgrades. In addition, AT&T is adding HSPA carriers at cell sites on a “market-by-market basis” and upgrading their backhaul network to handle the increased data traffic. All of these are legitimate steps to address customer concerns, but they may be too little too late. The AT&T/Apple exclusivity contract is rumored to expire in June of 2010. Unless AT&T can convince Apple to extend the exclusivity contract, it has a very small window to fix its network and improve customer satisfaction before AT&T begins to see a very high churn rate among unhappy iPhone users. As one customer said, “What's the point of upgrading your network for future customers if when that time comes you don't have any customers left?” AT&T must act quickly and efficiently to stem the tide of negative sentiment among iPhone users.

Main Recommendations:

- 1. Improve wireless broadband network:** Due to the fanatical acceptance of the iPhone, AT&T is now suffering from congested broadband networks as smartphone users consume more broadband space for wireless and data services. In order to successfully serve iPhone and other smartphone users, AT&T must enhance its broadband network capacity to effectively serve customers. Despite reported issues, AT&T reduced capital spending from \$20 billion in 2008 to \$17 billion in 2009 to upgrade its wireline and wireless network. Our team recommends using AT&T's cash flow from

operations to increase network investments from \$17 billion to \$20 billion. After investing in enhancing their wireless network, AT&T needs to communicate these investments to consumers to show AT&T's commitment.

2. Drive loyalty through satisfaction: In order for AT&T to keep their customers loyal and drive long-term profits, they must ensure customer satisfaction. Driving satisfaction may be an "uphill battle;" many customers are overly critical of AT&T since they became subscribers for the iPhone, not the network (Satisfaction=Performance-Expectations).

Nevertheless, AT&T must win this customer satisfaction battle. We recommend:

- **Create a customer appreciation program.** AT&T should recognize loyal customers with anniversary gifts (a discounted bill on 1, 5, and 10 year anniversary with AT&T), discounts on new devices, and even special rates. Taking time to acknowledge the loyal customers will surely reduce churn rates and promote further loyalty.
- **Communicate high subsidy that AT&T pays for each iPhone.** As mentioned above, AT&T pays \$325 for each iPhone sold, but customers do not know that. AT&T needs to take the credit for bringing the cost of the device down to a reasonable price and allowing so many customers to be iPhone users.
- **Offer plan upgrades as an alternative to overage fees.** Like AT&T's main competitor (Verizon), when a customer exceeds their plan's allowance for minutes or texts, AT&T should offer a plan upgrade instead of insisting on overage fees. This alternative would reinforce that AT&T cares about their customers and are willing to work with them as opposed to against them. Small gestures like this improve customer satisfaction because they are not a part of original expectations.

3. Extend the AT&T/iPhone exclusivity contract beyond June 2010: The iPhone has lured many new customers to AT&T (4.3 million) and, according to Mintel, carrier/smartphone manufacturer relationships will continue to drive consumer choice among carriers. Hence, AT&T must do all it can to extend the exclusivity contract with Apple. Not only to drive new customers, but also to give AT&T enough time to make 3G network improvements and increase customer satisfaction while they have these customers captive in their network.

Financial Analysis & Recommendations:

Accounting Issues in the Wireless Industry: Before analyzing AT&T's financial position in light of our recommendations, it is important to address the accounting methods of AT&T and its competitors. If they diverge, adjustments would need to be made to the financial statements of all the competitors before accurate comparisons between the companies could be

made. The major players in the wireless industry (AT&T, Verizon, SprintNextel and T-Mobile USA) have very similar accounting methods. Although there are subtleties in some areas, the accounting methods for wireless-centric companies, including intangible asset valuation and impairments, revenue recognition and physical inventory valuation are essentially the same for AT&T Wireless and its competitors. As such, no changes were made to the financial statements of AT&T or its competitors.

There are both finite and indefinite-lived intangible assets that are unique to the wireless industry and accounted for similarly. Finite-lived intangible assets are amortized over their useful lives and reviewed for impairment periodically. Indefinite life intangible assets are not amortized, but tested periodically for impairment. One important area of divergence is the reversal of impairment losses. Under US Generally Accepted Accounting Principles (GAAP), impairment losses cannot be reversed, while under International Financial Reporting Standards (IFRS), impairment losses may be reversed if the reasons for recognizing the original impairment loss no longer apply. This caveat applies to T-Mobile USA, whose parent company, Deutsche Telekom, is based in Germany. T-Mobile did not make any asset impairment reversals during the 2008 accounting cycle.

Finite-lived intangible assets common to the wireless industry include customer relationships, customer lists, tradenames and patents. Customer relationships are amortized using either the sum of the months digits method or the sum of the years digits method over the period in which those relationships are expected to contribute to future cash flows. The sum of the months (or years) digits method reflects the expectation that there will be greater revenue generation from these customer relationships during the earlier years of their lives. Customer lists, tradenames and patents are amortized using the straight-line method of amortization and tested for impairment periodically.

Indefinite life intangible assets include goodwill and wireless FCC licenses. Although the FCC licenses only last for ten years at a time, renewals occur routinely enough to consider them an indefinite life asset. Across all companies, revenue is recognized when service is provided. Upfront service and activation fees are deferred and recognized over the average customer relationship period. Revenues generated from handset sales are recognized at the time of sale; subsidies on handsets are recorded as a loss at the time of sale. Inventory is immaterial in the wireless industry as it is largely service-based. AT&T and T-Mobile did not divulge their cost of inventory accounting methods. Both Verizon and Sprint use the first-in, first-out (FIFO) method.

Past Financial Performance Relative to Competition:

The telecommunications industry is characterized by large amounts of fixed capital investment in network equipment and by relatively high financial leverage to finance the fixed assets. While AT&T is the largest telecom company in terms of revenues or net income, Verizon has somewhat better ROA and ROE figures than AT&T (see Appendix A for all comparisons in this paragraph). AT&T has an industry leading 9.7% net income margin. AT&T also has comparable asset turnover, liquidity, and solvency ratios relative to the rest of the industry. In the previous three years, AT&T has led the industry in growth rates of total revenue, gross profit, and dividends per share. These financial metrics indicate that while AT&T is asset-intensive, the company still effectively uses its assets and reasonable amounts of financial leverage to generate solid returns for shareholders. AT&T has the second-lowest churn rate in the industry (behind Verizon), the highest ARPU, and the largest number of wireless subscribers until recently being surpassed by Verizon. AT&T's market cap exceeds that of Verizon (\$165 billion to \$95 billion).

Forecasting Financial Performance: AT&T has a long history of increasing earnings and dividends for its shareholders.

However, due to recent merger activity the last three years are the most relevant period for estimating future earnings and dividends growth. Namely, AT&T's merger with SBC in November 2005 and the consolidation with BellSouth/Cingular/AT&T Wireless in December 2006 would provide inaccurate forecasts if used to estimate future revenue and profit growth, as the company almost tripled in size as a result of the mergers. The company's potential growth is best predicted using analyst estimates and the three-year period from 2007 through 2009. In addition, the Dividend Discount Model (DDM) was used to value an established, dividend-paying firm in a mature industry such as AT&T. According to our model, the risk-adjusted present value of AT&T's future dividends is \$30.24 per share. This is approximately equal to AT&T's current stock price, which is trading in a range between \$25 and \$28 per share during the last three months and recently closed at \$27.97. This indicates that AT&T's stock is fairly priced, and that the market has discounted the company's network quality problems and potential loss of the iPhone into the share price.

Analysis and Assumptions: Revenues and expenses are expected to grow at 1% per year during 2010. Revenue growth is slow for AT&T and most telecom providers as the economy recovers from the worst recession in decades and consumers are somewhat reluctant to make discretionary purchases. Cost of goods sold and SG&A expense will grow at 1% in 2010 as

AT&T continues to successfully contain costs as it did in 2009. It is also assumed that AT&T will keep depreciation expense and interest expense constant in 2010 as it did in 2009. Starting in 2011, it is assumed that revenues, cost of goods sold, and SG&A expense will grow at 5% per year, in line with projected nominal GDP growth. These conservative assumptions reflect our belief that AT&T's revenues will grow in line with the real economy and the inflation rate, and the company's major costs will do the same. AT&T's major business lines are either in mature, slowing industries (wireline, advertising and publishing, and business services) or in intensely competitive, increasingly commoditized industries (wireless service). The nature of the competitive forces faced by AT&T and the company's enormous size would make growth above 5% very difficult to achieve, especially in the long-term. Also, the company will struggle to secure inputs needed to generate revenues if COGS and SG&A do not increase in line with nominal GDP. Starting in 2010, depreciation expense and interest expense are assumed to increase at 2% per year. The company's effective tax rate of 34% is assumed to continue indefinitely into the future.

Required Rate of Return (CAPM) and Dividends: Based upon the previous three years' dividend payments, AT&T appears to have a target payout ratio of 70%-80% of earnings. As earnings are cyclically depressed due to the economic downturn, the payout ratio is currently at the upper end of the payout range. With dividends projected to grow at 5% per year, the payout ratio will decline from 83% to 71% in five years and 69% at the terminal value, at which point dividends will grow at 5% in perpetuity. The company's most recent dividend of \$1.64 translates to a 6% dividend yield on the company's shares. Thus the expected return on the company's shares is approximately 11%. We have also estimated an 11% required rate of return on the company's shares using the Capital Asset Pricing Model (CAPM). A risk-free rate of approximately 4% can be extrapolated from the yields for 10-year and 30-year Treasury securities (approximately 3.5% and 4.4% respectively) for long-lived assets such as AT&T's network. Based on empirical observation, a 7% historical market risk premium has been observed in the stock market. Finally, we have estimated the beta of AT&T's equity to be 1.0, which we feel is more indicative of the riskiness of the company's assets than the observed beta of 0.85. Specifically, the company has increasingly become reliant upon growth in newer, more-risky segments such as wireless, data, and fiber optic (U-Verse TV) and less reliant upon the declining wireline segment. Sprint Nextel, with a beta of 1.15, is a proxy for a firm that is involved almost exclusively in wireless. The segments now driving AT&T's growth more resemble a cyclical technology company than a stodgy, countercyclical telecommunications utility like the old Ma Bell. It is in these segments that most of the

company's capital expenditures will be directed; we believe that the riskiness of AT&T's assets going forward is equal to the average risk of the market portfolio.

Capital Structure: AT&T's capital structure is approximately 40% long-term debt and 60% common equity, with no preferred stock or hybrid securities. The company should not favor debt over equity or change its target capital structure, as AT&T's stock is not overvalued and the company's debt rating (A) means it can still borrow on favorable terms. Share buybacks of 30 million shares per year have been assumed based upon recent activity by the company but are not expected to affect long-term capital structure. We do not advise that the company increase buybacks above this rate due to an already high dividend combined with wireless network capital expenditure needs, and we do not advise that the company cut its dividend either. Any cut in the dividend would provide a negative signal to the capital markets, so a manageable 5%-6% annual increase in dividends paid is advised. These dividends can be safely paid from AT&T's operating cash flows.

Capital Expenditures: We recommend that AT&T accelerate capital expenditures for the wireless network in order to improve network quality and maintain a low customer churn rate. To this end, the company has accumulated \$6.2 billion in cash on the balance sheet in order to weather the recession, up from \$1.8 billion at year-end 2008. With improving economic conditions, AT&T can return to 2007-2008 levels of capital spending. Since cash flow from investing used for capital spending decreased by \$3.2 billion from 2008 to 2009, capital expenditures probably need to increase by at least this amount in 2010. In addition to balance sheet cash, AT&T has ample cash flow from operations (\$36.3 billion in 2009) to pay for the bulk of the much needed capital expenditures; these cheap internal funds and limited new borrowing should provide the most cost-effective way for the company to fund needed network improvements.

"On my honor, I have neither given nor received unauthorized aid in completing this academic work."

Matt Dahlquist

Clint Gill

Jessica Shoemaker

Sergio Trujillo

Appendix A – Financial Performance Metrics (previous 12 months unless otherwise stated)

<u>Profitability</u>	Return on Assets	Return on Capital	Return on Equity	Total Revenue	Net Income
AT&T Inc.	4.9%	7.4%	11.2%	\$123.236 billion	\$11.92 billion
Verizon Comm.	5.6%	8.7%	11.8%	\$105.362 billion	\$5.539 billion
Sprint Nextel	(0.9%)	(1.2%)	(15.6%)	\$32.822 billion	(\$3.077) billion
T-Mobile USA	4.4%	5.8%	6.1%	\$21.842 billion	\$1.647 billion

<u>Margin Analysis</u>	Gross Margin %	SG&A Margin %	EBITDA Margin %	EBIT Margin %	Net Inc. Margin %
AT&T Inc.	59.0%	25.5%	33.5%	17.5%	9.7%
Verizon Comm.	60.6%	27.2%	33.6%	18.4%	5.3%
Sprint Nextel	55.3%	34.7%	20.7%	(2.5%)	(9.4%)
T-Mobile USA	59.7%	31.7%	28.0%	14.9%	7.5%

<u>Asset Turnover</u>	Total Asset Turn.	Fixed Asset Turn.	A/R Turnover	Inventory Turn.	
AT&T Inc.	0.4x	1.3x	7.1x	NA	
Verizon Comm.	0.5x	1.2x	8.7x	16.5x	
Sprint Nextel	0.6x	1.5x	9.9x	25.2x	
T-Mobile USA	0.5x	1.8x	8.2x	9.9x	

<u>Liquidity</u>	Current Ratio	Quick Ratio	Op CF/Cur Liab.	Days Sales Outst.	Days Payable Out.
AT&T Inc.	0.8x	0.6x	1.1x	51.2	132.7
Verizon Comm.	0.8x	0.5x	1.1x	41.9	124.4
Sprint Nextel	1.6x	1.4x	0.7x	36.7	59.8
T-Mobile USA	0.7x	0.4x	0.6x	44.8	131.7

<u>Solvency</u>	Tot. Debt/Capital	LT Debt/Capital	EBIT/Interest Exp.	EBITDA/Int. Exp.	Net Debt/EBITDA
AT&T Inc.	42.1%	38.2%	6.3x	12.2x	1.6x
Verizon Comm.	42.6%	38.9%	6.6x	12.1x	1.7x
Sprint Nextel	54.3%	52.4%	NM	4.6x	2.3x
T-Mobile USA	27.7%	27.7%	NA	NA	1.5x

<u>Growth (2007-09)</u>	Total Revenue	Gross Profit	EBIT	Net Income	Dividends/Share
AT&T Inc.	8.6%/yr.	7.8%/yr.	10.6%/yr.	5.3%/yr.	7.5%/yr.
Verizon Comm.	6.9%/yr.	7.4%/yr.	10.5%/yr.	0.5%/yr.	6.2%/yr.
Sprint Nextel	-10.2%/yr.	-15.3%/yr.	NM	NM	NA
T-Mobile USA	8.0%/yr.	6.7%/yr.	10.8%/yr.	9.6%/yr.	NA

<u>Market Valuation</u>	Market Cap	P/E ratio (trailing)	Dividend Yield	P/BV	TEV/EBIT
AT&T Inc.	\$165.11 billion	13.88x	6.00%	1.55x	9.97x
Verizon Comm.	\$95.47 billion	17.24x	5.70%	1.97x	9.48x
Sprint Nextel	\$11.74 billion	NM	0.00%	0.53x	NM
T-Mobile USA	NA	NA	NA	NA	NA

<u>Industry Metrics (2008)</u>	Wireless Subscribers	Churn Rate - Wireless	Gross Adds - Wireless	Net Adds - Wireless	ARPU - Wireless
AT&T Inc.	77 million	1.7%	21.4 million	7.0 million	\$59.59/month
Verizon Comm.	72.1 million	1.25%	NM	6.4 million	\$51.59/month
Sprint Nextel	48.3 million	2.58%	NM	(4.7 million)	\$53.00/month
T-Mobile USA	32.8 million	2.9%	NM	4.1 million	\$51.00/month

Appendix B – Projected Income Statement/Financial Statements (\$ amounts are millions)

Income Statement				PROJECTED					TERMINAL VALUE	
For the Fiscal Period Ending	Reclassified 12 months Dec-31-2007 USD	12 months Dec-31-2008 USD	LTM 12 months Sep-30-2009 USD	Dec-31-2010 USD	Dec-31-2011 USD	Dec-31-2012 USD	Dec-31-2013 USD	Dec-31-2014 USD	Dec-31-2015 USD	
Currency										
Revenue	107,378.0	111,358.0	111,106.0	112,217.1	117,827.9	123,719.3	129,905.3	136,400.5	143,220.6	
Other Revenue	11,550.0	12,670.0	12,130.0	12,251.3	12,863.9	13,507.1	14,182.4	14,891.5	15,636.1	
Total Revenue	118,928.0	124,028.0	123,236.0	124,468.4	130,691.8	137,226.4	144,087.7	151,292.1	158,856.7	
Cost Of Goods Sold	46,705.0	49,895.0	50,586.0	51,091.9	53,646.5	56,328.8	59,145.2	62,102.5	65,207.6	
Gross Profit	72,223.0	74,133.0	72,650.0	73,376.5	77,045.3	80,897.6	84,942.5	89,189.6	93,649.1	
Selling General & Admin Exp.	30,242.0	31,187.0	31,378.0	31,691.8	33,276.4	34,940.2	36,687.2	38,521.6	40,447.6	
R & D Exp.	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
Depreciation & Amort.	21,577.0	19,883.0	19,743.0	19,743.0	20,137.9	20,540.6	20,951.4	21,370.5	21,797.9	
Other Operating Expense/(Income)	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
Other Operating Exp., Total	51,819.0	51,070.0	51,121.0	51,434.8	53,414.2	55,480.8	57,638.6	59,892.0	62,245.5	
Operating Income	20,404.0	23,063.0	21,529.0	21,941.7	23,631.1	25,416.8	27,303.8	29,297.6	31,403.6	
Interest Expense	(3,507.0)	(3,390.0)	(3,394.0)	(3,394.0)	(3,461.9)	(3,531.1)	(3,601.7)	(3,673.8)	(3,747.3)	
Interest and Invest. Income	166.0	148.0	148.0	149.5	151.0	152.5	154.0	155.5	157.1	
Net Interest Exp.	(3,341.0)	(3,242.0)	(3,246.0)	(3,244.5)	(3,310.9)	(3,378.6)	(3,447.7)	(3,518.2)	(3,590.1)	
Income/(Loss) from Affiliates	692.0	819.0	656.0	662.6	669.2	675.9	682.6	689.5	696.4	
Currency Exchange Gains (Loss)	-	-	1.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other Non-Operating Inc. (Exp.)	(108.0)	(211.0)	(265.0)	(267.7)	(270.3)	(273.0)	(275.8)	(278.5)	(281.3)	
EBT Excl. Unusual Items	17,647.0	20,429.0	18,675.0	19,092.1	20,719.0	22,441.0	24,263.0	26,190.3	28,228.5	
Merger & Related Restruct. Charge	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
Impairment of Goodwill	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
Gain (Loss) On Sale Of Invest.	-	(180.0)	(243.0)	(245.4)	(247.9)	(250.4)	(252.9)	(255.4)	(257.9)	
Gain (Loss) On Sale Of Assets	557.0	121.0	210.0	212.1	214.2	216.4	218.5	220.7	222.9	
Asset Writedown	-	(467.0)	(494.0)	(498.9)	(503.9)	(509.0)	(514.1)	(519.2)	(524.4)	
Other Unusual Items	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
EBT Incl. Unusual Items	18,204.0	19,903.0	18,148.0	18,559.8	20,181.5	21,898.0	23,714.6	25,636.4	27,669.1	
Income Tax Expense	6,253.0	7,036.0	6,180.0	6,310.3	6,861.7	7,445.3	8,063.0	8,716.4	9,407.5	
Minority Int. in Earnings	-	-	(48.0)	(48.0)	(48.0)	(48.0)	(48.0)	(48.0)	(48.0)	
Earnings from Cont. Ops.	11,951.0	12,867.0	11,920.0	12,201.5	13,271.8	14,404.7	15,603.6	16,872.0	18,213.6	
Earnings of Discontinued Ops.	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
Extraord. Item & Account. Change	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
Net Income	11,951.0	12,867.0	11,920.0	12,201.5	13,271.8	14,404.7	15,603.6	16,872.0	18,213.6	
Pref. Dividends and Other Adj.	-	-	-	0.0	0.0	0.0	0.0	0.0	0.0	
NI to Common Incl Extra Items	11,951.0	12,867.0	11,920.0	12,201.5	13,271.8	14,404.7	15,603.6	16,872.0	18,213.6	
NI to Common Excl. Extra Item	11,951.0	12,867.0	11,920.0	12,201.5	13,271.8	14,404.7	15,603.6	16,872.0	18,213.6	
Earnings growth				2.31%	8.06%	7.87%	7.68%	7.52%	7.37%	
Per Share Items										
Basic EPS	\$1.951	\$2.171	\$2.021	\$ 2.079	\$ 2.273	\$ 2.480	\$ 2.701	\$ 2.935	\$ 3.185	
Basic EPS Excl. Extra Items	1.951	2.171	2.021	2.079	2.273	2.480	2.701	2.935	3.185	
Weighted Avg. Basic Shares Out.	6,127.0	5,927.0	5,897.8	5,867.8	5,837.8	5,807.8	5,777.8	5,747.8	5,717.8	
EPS growth				2.81%	8.53%	8.34%	8.16%	8.00%	7.85%	
Diluted EPS	\$1.938	\$2.161	\$2.015	\$ 2.071	\$ 2.264	\$ 2.470	\$ 2.690	\$ 2.923	\$ 3.172	
Diluted EPS Excl. Extra Items	1.938	2.161	2.015	2.071	2.264	2.470	2.690	2.923	3.172	
Weighted Avg. Diluted Shares Out.	6,170.0	5,958.0	5,921.3	5,891.3	5,861.3	5,831.3	5,801.3	5,771.3	5,741.3	
Dividends per Share	\$1.47	\$1.61	\$1.64	\$ 1.72	\$ 1.81	\$ 1.90	\$ 1.99	\$ 2.09	\$ 2.20	
Payout Ratio %	73.2%	73.9%	80.6%	82.81%	79.53%	76.54%	73.81%	71.31%	68.99%	
Discount Factor				1.05	1.17	1.30	1.44	1.60	1.60	
Terminal Value									\$36.63	
PV of Dividend				\$1.63	\$1.55	\$1.46	\$1.38	\$1.31	\$22.90	
Sum of PV of Dividends									\$30.24	

Balance Sheet

Balance Sheet as of:

Currency	Dec-31-2007 USD	Dec-31-2008 USD	Sep-30-2009 USD
ASSETS			
Cash And Equivalents	1,970.0	1,792.0	6,167.0
Total Cash & ST Investments	1,970.0	1,792.0	6,167.0
Accounts Receivable	16,185.0	16,047.0	14,796.0
Total Receivables	16,185.0	16,047.0	14,796.0
Inventory	1,119.0	862.0	-
Prepaid Exp.	1,524.0	1,538.0	1,791.0
Deferred Tax Assets, Curr.	2,044.0	1,014.0	991.0
Other Current Assets	1,844.0	1,303.0	2,176.0
Total Current Assets	24,686.0	22,556.0	25,921.0
Gross Property, Plant & Equipment	210,518.0	218,579.0	225,669.0
Accumulated Depreciation	(114,628.0)	(119,491.0)	(127,348.0)
Net Property, Plant & Equipment	95,890.0	99,088.0	98,321.0
Long-term Investments	2,270.0	2,332.0	3,268.0
Goodwill	70,713.0	71,829.0	71,727.0
Other Intangibles	58,402.0	63,712.0	61,416.0
Loans Receivable Long-Term	-	-	-
Other Long-Term Assets	23,683.0	5,728.0	5,915.0
Total Assets	275,644.0	265,245.0	266,568.0
LIABILITIES			
Accounts Payable	9,276.0	8,401.0	18,093.0
Accrued Exp.	9,775.0	9,647.0	-
Short-term Borrowings	1,921.0	4,616.0	25.0
Curr. Port. of LT Debt	4,939.0	9,503.0	6,730.0
Curr. Income Taxes Payable	4,342.0	115.0	1,965.0
Unearned Revenue, Current	5,919.0	5,833.0	4,036.0
Other Current Liabilities	3,102.0	4,175.0	2,419.0
Total Current Liabilities	39,274.0	42,290.0	33,268.0
Long-Term Debt	57,255.0	60,872.0	65,909.0
Minority Interest	-	-	428.0
Pension & Other Post-Retire. Benefits	26,312.0	34,044.0	31,750.0
Def. Tax Liability, Non-Curr.	24,939.0	19,196.0	22,279.0
Other Non-Current Liabilities	12,497.0	12,496.0	13,361.0
Total Liabilities	160,277.0	168,898.0	166,995.0
Common Stock	6,495.0	6,495.0	6,495.0
Additional Paid In Capital	91,638.0	91,728.0	91,678.0
Retained Earnings	33,297.0	36,591.0	38,841.0
Treasury Stock	(15,683.0)	(21,410.0)	(21,280.0)
Comprehensive Inc. and Other	(380.0)	(17,057.0)	(16,161.0)
Total Common Equity	115,367.0	96,347.0	99,573.0
Total Equity	115,367.0	96,347.0	99,573.0
Total Liabilities And Equity	275,644.0	265,245.0	266,568.0

Cash Flow			
For the Fiscal Period Ending	Restated 12 months Dec-31-2007 USD	12 months Dec-31-2008 USD	LTM 12 months Sep-30-2009 USD
Currency			
Net Income	11,951.0	12,867.0	11,920.0
Depreciation & Amort.	15,625.0	15,313.0	15,173.0
Amort. of Goodwill and Intangibles	5,952.0	4,570.0	4,570.0
Depreciation & Amort., Total	21,577.0	19,883.0	19,743.0
(Gain) Loss From Sale Of Assets	(409.0)	-	-
(Gain) Loss On Sale Of Invest.	(11.0)	517.0	608.0
(Income) Loss on Equity Invest.	(297.0)	(654.0)	(654.0)
Provision & Write-off of Bad debts	1,617.0	1,796.0	1,883.0
Net Cash From Discontinued Ops.	-	-	-
Other Operating Activities	1,826.0	5,419.0	2,864.0
Change in Acc. Receivable	(1,491.0)	(1,421.0)	43.0
Change in Acc. Payable	672.0	(5,563.0)	34.0
Change in Other Net Operating Assets	(1,193.0)	812.0	(77.0)
Cash from Ops.	34,242.0	33,656.0	36,364.0
Capital Expenditure	(17,888.0)	(20,335.0)	(17,112.0)
Sale of Property, Plant, and Equipment	1,294.0	1,385.0	(59.0)
Cash Acquisitions	(2,873.0)	(10,972.0)	(1,070.0)
Divestitures	300.0	230.0	435.0
Invest. in Marketable & Equity Secur.	455.0	504.0	157.0
Net (Inc.) Dec. in Loans Originated/Sold	-	-	-
Other Investing Activities	36.0	45.0	56.0
Cash from Investing	(18,676.0)	(29,143.0)	(17,593.0)
Short Term Debt Issued	-	2,017.0	-
Long-Term Debt Issued	11,367.0	12,416.0	-
Total Debt Issued	11,367.0	14,433.0	6,482.0
Short Term Debt Repaid	(3,411.0)	-	-
Long-Term Debt Repaid	(6,772.0)	(4,010.0)	-
Total Debt Repaid	(10,183.0)	(4,010.0)	(10,955.0)
Issuance of Common Stock	1,986.0	319.0	10.0
Repurchase of Common Stock	(10,390.0)	(6,077.0)	0
Common Dividends Paid	(8,743.0)	(9,507.0)	(9,609.0)
Total Dividends Paid	(8,743.0)	(9,507.0)	(9,609.0)
Special Dividend Paid	-	-	-
Other Financing Activities	(51.0)	151.0	(126.0)
Cash from Financing	(16,014.0)	(4,691.0)	(14,198.0)
Net Change in Cash	(448.0)	(178.0)	4,573.0

Appendix C - Sensitivity Analysis

In order to determine the sensitivity of our model to changes in assumptions, we created a matrix for possible per share value as the discount rate and growth rate of dividends change, holding all else constant.

Estimated PV	Dividend Growth Rate								
Discount Rate	3%	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%	6.50%	7.00%
9%	\$29.39	\$32.22	\$35.61	\$39.76	\$44.95	\$51.61	\$60.50	\$72.94	\$91.60
9.50%	\$27.19	\$29.60	\$32.45	\$35.87	\$40.04	\$45.26	\$51.97	\$60.92	\$73.45
10.00%	\$25.31	\$27.39	\$29.81	\$32.68	\$36.12	\$40.33	\$45.58	\$52.34	\$61.35
10.50%	\$23.68	\$25.49	\$27.58	\$30.03	\$32.91	\$36.38	\$40.61	\$45.90	\$52.70
11.00%	\$22.25	\$23.84	\$25.67	\$27.78	\$30.24	\$33.14	\$36.63	\$40.89	\$46.22
11.50%	\$20.98	\$22.40	\$24.01	\$25.85	\$27.97	\$30.45	\$33.38	\$36.89	\$41.18
12.00%	\$19.86	\$21.13	\$22.56	\$24.18	\$26.03	\$28.17	\$30.66	\$33.61	\$37.14
12.50%	\$18.86	\$20.00	\$21.28	\$22.72	\$24.35	\$26.22	\$28.37	\$30.88	\$33.84
13.00%	\$17.96	\$18.99	\$20.15	\$21.43	\$22.88	\$24.52	\$26.40	\$28.56	\$31.09

Appendix D – Regression Analysis for Equity Beta Coefficient

SUMMARY OUTPUT

Daily Return AT&T

<i>Regression Statistics</i>	
Multiple R	0.74839593
R Square	0.560096467
Adjusted R Square	0.559746504
Standard Error	0.011404079
Observations	1259

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	0.20814267	0.20814267	1600.444659	2.1279E-226
Residual	1257	0.163476653	0.000130053		
Total	1258	0.371619323			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>	<i>Upper 95%</i>	<i>Lower 95.0%</i>	<i>Upper 95.0%</i>
Intercept	0.000366825	0.000321403	1.141322881	0.253952966	-0.000263721	0.00099737	-0.000263721	0.00099737
Daily Return S&P	0.849273744	0.021228894	40.00555786	2.1279E-226	0.807625775	0.890921713	0.807625775	0.890921713

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