Daiwa Securities

AT&T Inc.

Global Credit Research GCRE103

Raises FY23 cash flows guidance

- 3Q23 Revenues increased 1% y/y to $30.4bn; Adjusted EBITDA increased 4.6% y/y to $11.2bn driven by higher Mobility, Consumer Wireline and Mexico, partially offset by lower Business Wireline
- Free operating cash flow increased 37% y/y to $5.7bn; Cash and cash equivalents totaled $9.3bn
- Credit positive given the large and growing revenues, healthy profit margins and a strong financial position

FICC Research Dept.

Senior Credit Analyst
Stefan Tudor, CFA
(81) 3 5555-8754
stefan.tudor@daiwa.co.jp

Daiwa Securities Co. Ltd.

Credit Opinion

We maintain our credit positive outlook given AT&T's large and growing revenues, healthy profit margins and the company's strong financial position. Revenues continue to grow with 3Q23 revenues up 1% y/y to $30.4bn. The main revenue growth drivers are Mobility and Fiber which continue to expand their customer base, more than offsetting the declines for legacy voice and data services. Mexico also showed a strong performance in the quarter with revenues growing 26% y/y due to growth of both services and equipment revenues. Postpaid phone churn rate remains low at 0.79% in the quarter reflecting AT&T's strong market position.

AT&T continues to have healthy profit margins, with adjusted EBITDA margins increasing 1.2pp y/y to 36.9%. Mobility segment continues to be the most profitable segment with EBITDA margins of 43%. The growing profit margins are also supported by the cost savings actions that AT&T has been taking over the past years. AT&T achieved over $6bn of run-rate cost savings ahead of schedule and increased target to over $8bn of run-rate cost savings over the next 3 years.

Supported by growing revenues and improved profitability, AT&T continue to generate rich cash flows. In 3Q23, the cash from operations increased 2.6% y/y to $10.3bn and free operating cash flows increased 37% y/y to $5.7bn. Given the continued subscriber and revenue growth, AT&T raised FY23 free operating cash flows guidance. The management now expects FY23 free operating cash flows to be about $16.5bn vs prior guidance of over $16bn. We expect free cash flows to continue its growth trend into 2024. There are 2 main factors that should support this growth trend. The first one is a more profitable business supported by the cost actions taken so far. The second factor is lower needs for capital investments comparing with the high CapEx levels in 2022 and 2023.

AT&T has a strong financial position with $9.3bn of cash and marketables on its balance sheet. Total debt decreased 3.7% q/q to $138bn and we expect AT&T to continue to deleverage in the following years. AT&T maintains its target to achieve a net debt-to-adjusted EBITDA ratio in the 2.5x range in the first half of 2025. We expect tighter financing conditions to have a limited impact on AT&T giving its debt profile. More than 95% of the long-term debt is fixed at an average rate of 4.2% and has a weighted average maturity of 16 years.

3Q23 Financial Highlights

Revenues increased 1% y/y to $30.4bn due to higher Mobility, Mexico and Consumer Wireline revenues, partially offset by lower Business Wireline revenues.

Mobility revenues increased 2% y/y to $20.7bn due to higher service revenues, partially offset by lower equipment revenues. Service revenues increased 3.7% y/y to $15.9bn mainly driven by subscriber and postpaid phone ARPU growth. Equipment revenues decreased 3.2% y/y to $4.8bn due to lower device volumes. Mobility subscriber base continues to grow with 468,000 of postpaid phone net adds. Postpaid phone churn rate (the percentage of subscribers who
canceled during the period) was stable q/q at 0.79%. Postpaid phone ARPU increased 0.6% y/y to $55.99 due to pricing actions, higher international roaming and a mix shift to higher-priced unlimited plans.

Business Wireline revenues decreased 7.9% y/y to $5.2bn due to lower demand for legacy voice and data services and product simplification, partially offset by growth in connectivity services.

Consumer Wireline revenues increased 4.6% y/y to $3.3bn as gains in broadband surpassed declines in legacy voice and data services. Broadband revenues increased 9.8% y/y due to fiber growth of 27%, partially offset by non-fiber revenue declines of 9%. AT&T Fiber subscriber base continues to grow with 296,000 of net adds in the quarter.

Latin America (Mexico) revenues increased 26% y/y to $992m due to growth of both service and equipment revenues. Service revenues increased 20% y/y to $672m driven by favorable foreign exchange and stable subscriber and wholesale revenues. Equipment revenues increased 42% y/y to $320m due to higher sales and favorable foreign exchange.

Adjusted EBITDA (EBITDA less certain items that are non-operational or non-recurring in nature) **increased 4.6% y/y to $11.2bn** driven by higher Mobility, Consumer Wireline and Mexico, partially offset by lower Business Wireline. AT&T continues its efforts to improve the cost structure, targeting over $2bn of incremental cost savings within the next 3 years.

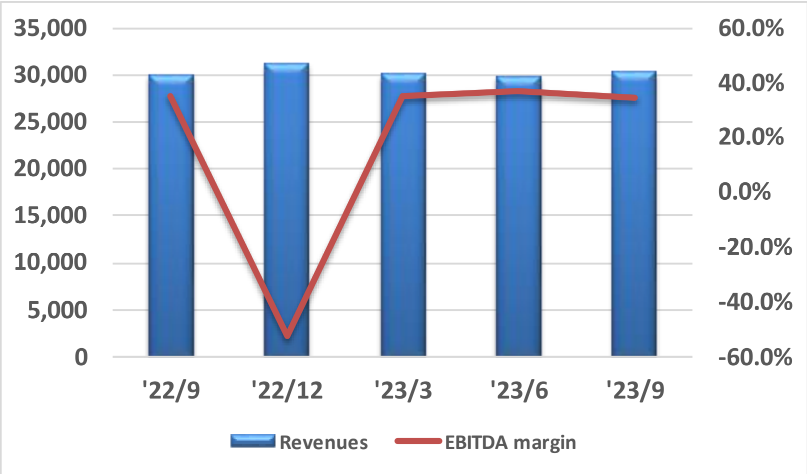
By business segment, Mobility EBITDA increased 7.6% y/y to $8.9bn and EBITDA margin improved 2.2pp y/y to 43%. Business Wireline EBITDA decreased 14% y/y to $1.7bn and EBITDA margin decreased 2.1pp y/y to 32.5%. Consumer Wireline EBITDA increased 9.4% y/y to $1bn and EBITDA margin increased 1.4pp y/y to 31%. Latin America EBITDA increased 54% y/y to $155m and EBITDA margin increased 2.7pp y/y to 15.6%.

Free operating cash flow (FOCF) increased 37% y/y to $5.7bn due to higher operating cash flows and lower CapEx. Cash from operating activities (CFO) increased 2.6% y/y to $10.3bn, reflecting higher cash receipts from improved operations as well as timing of working capital, including lower device payments. Capital expenditures decreased 22% y/y to $4.6bn. Capital investment was $5.6bn, including $1bn of cash payments for vendor financing.

Net debt decreased 3.8% q/q to $128.7bn as the end of 3Q23. Total debt decreased 3.7% q/q to $138bn. Total cash and marketables decreased 18% q/q to $9.3bn. Net debt-to-adjusted EBITDA decreased 0.1 q/q to 2.99 as the end of 3Q23. AT&T maintains its target to achieve a net debt-to-adjusted EBITDA ratio in the 2.5x range in the first half of 2025.

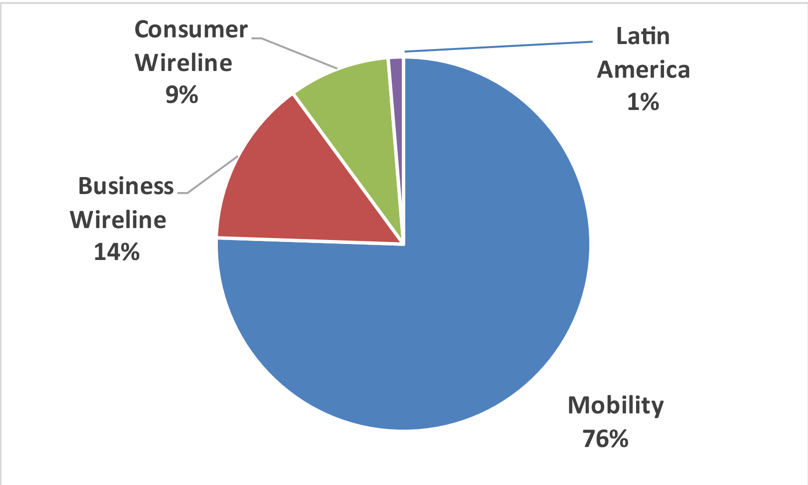
AT&T raised its cash flows guidance for FY23. FY23 Adjusted EBITDA is expected to grow over 4% y/y vs prior guidance of over 3% due to growing revenues and realized cost savings. FY23 Free operating cash flows are expected to be about $16.5bn vs prior guidance of over $16bn.

Chart 1: Total revenues ($m) and EBITDA margin (%)



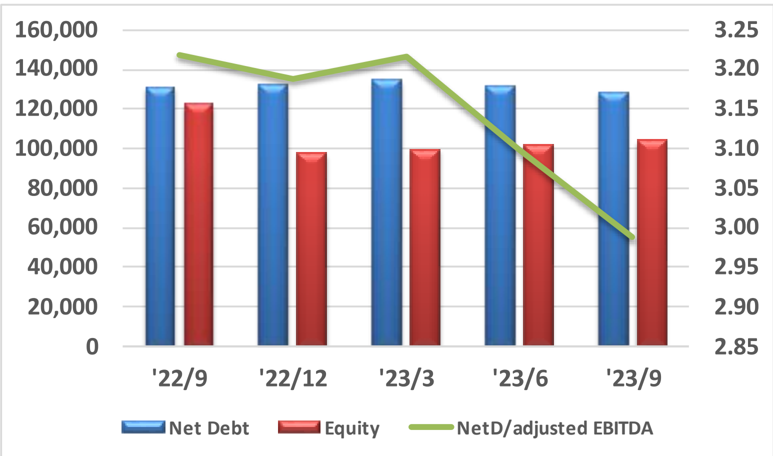
Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 2: Segment share in adjusted EBITDA (3Q23 Results)



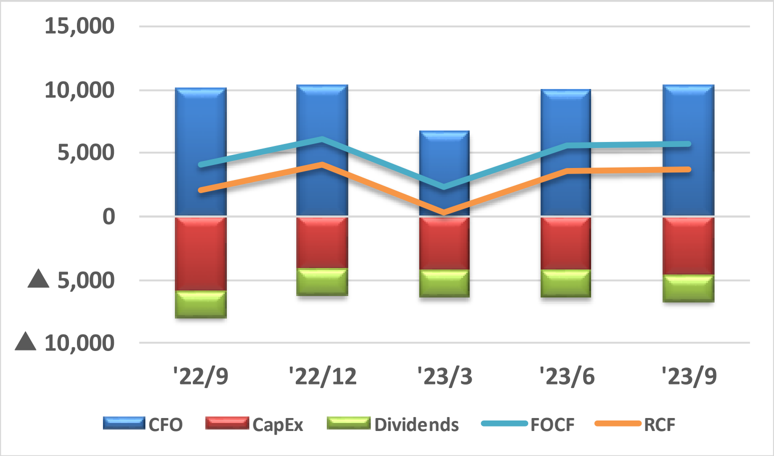
Source: Company materials, Bloomberg; compiled by Daiwa.

Chart 3: Balance sheet ($m)



Source: Company materials, Bloomberg; compiled by Daiwa

Chart 4: Cash flows ($m)



Source: Company materials, Bloomberg; compiled by Daiwa
Residual cash flow (RCF)= Cash from operations- CapEx- Dividends

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Chart 5: Financial Results

($m) Period End	Q3 2022 '22/9	Q4 2022 '22/12	Q1 2023 '23/3	Q2 2023 '23/6	Q3 2023 '23/9	YOY	QOQ
■ P/L							
Revenues	30,043	31,343	30,139	29,917	30,350	1.0%	1.4%
Operating Income	6,012	▲ 21,092	6,002	6,406	5,782	-3.8%	-9.7%
Interest expense	▲ 1,420	▲ 1,560	▲ 1,708	▲ 1,608	▲ 1,662	17.0%	3.4%
Interest Coverage Ratio	*4.2*	*▲ 13.5*	*3.5*	*4.0*	*3.5*	*▲ 0.75*	*▲ 0.50*
Pretax Income	7,254	▲ 23,197	5,767	6,165	4,980	-31.3%	-19.2%
Net Income	5,977	▲ 23,571	4,176	4,437	3,444	-42.4%	-22.4%
EBITDA	10,526	▲ 16,497	10,633	11,081	10,487	-0.4%	-5.4%
EBITDA margin	*35.0%*	*-52.6%*	*35.3%*	*37.0%*	*34.6%*	*-0.5*	*-2.5*
Adjusted EBITDA	10,714	10,231	10,589	11,053	11,203	4.6%	1.4%
Adjusted EBITDA margin	*35.7%*	*32.6%*	*35.1%*	*36.9%*	*36.9%*	*1.25*	*-0.03*
■ C/F							
Cash from operations	10,071	10,313	6,678	9,922	10,336	2.6%	4.2%
Depreciation & Amortization	4,514	4,595	4,631	4,675	4,705	4.2%	0.6%
Cash from investing	▲ 10,894	▲ 3,823	▲ 3,818	▲ 5,423	▲ 4,545	-58.3%	-16.2%
CapEx	▲ 5,921	▲ 4,229	▲ 4,335	▲ 4,270	▲ 4,647	-21.5%	8.8%
Cash from financing	▲ 6,151	▲ 5,191	▲ 3,711	2,181	▲ 7,754	26.1%	---
Dividends	▲ 2,010	▲ 2,014	▲ 2,014	▲ 2,083	▲ 2,019	0.4%	-3.1%
Free cash flow (FCF)	▲ 823	6,490	2,860	4,499	5,791	---	28.7%
Free operating cash flow (FOCF)	4,150	6,084	2,343	5,652	5,689	37.1%	0.7%
Dividend payout ratio	48.4%	33.1%	86.0%	36.9%	35.5%	▲ 12.9	▲ 1.4
RCF (CFO-CapEx-Dividends)	2,140	4,070	329	3,569	3,670	71.5%	2.8%
Net cash flow	▲ 6,974	1,299	▲ 851	6,680	▲ 1,963	-71.9%	---
■ B/S							
Assets	426,463	402,853	400,873	408,453	406,698	-4.6%	-0.4%
Current assets	32,295	33,108	29,903	36,672	35,620	10.3%	-2.9%
Cash&Marketables	2,423	3,701	2,821	11,328	9,290	283.4%	-18.0%
Goodwill	92,725	67,895	67,895	67,854	67,854	-26.8%	0.0%
Liabilities	286,485	296,396	292,527	290,408	286,871	0.1%	-1.2%
Current liabilities	52,257	56,173	58,150	54,159	51,684	-1.1%	-4.6%
Total Debt	133,480	135,890	137,484	143,280	138,003	3.4%	-3.7%
ST Debt	9,626	7,467	13,757	15,268	11,302	17.4%	-26.0%
LT Debt	123,854	128,423	123,727	128,012	126,701	2.3%	-1.0%
Net Debt	131,057	132,189	134,663	131,952	128,713	-1.8%	-2.5%
Equity	122,406	97,500	99,396	101,903	103,703	-15.3%	1.8%
■ Financial Ratios							
Equity Ratio	28.7%	24.2%	24.8%	24.9%	25.5%	▲ 3.20	0.55
NetD/E	1.07	1.36	1.35	1.29	1.24	0.17	▲ 0.05
NetD/ EBITDA	3.43	10.70	10.37	8.38	8.20	4.77	▲ 0.19
NetD/adjusted EBITDA	3.22	3.19	3.22	3.10	2.99	▲ 0.23	▲ 0.11
ROA	4.7%	-2.1%	-2.3%	-2.2%	-2.8%	▲ 7.48	▲ 0.61
ROE	16.5%	-7.9%	-9.5%	-8.9%	-11.2%	▲ 27.72	▲ 2.28

Source: Company materials, Bloomberg; compiled by Daiwa.

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Chart 6: Segment Results

($m) Period End	Q3 2022 '22/9	Q4 2022 '22/12	Q1 2023 '23/3	Q2 2023 '23/6	Q3 2023 '23/9	YOY
Operating Revenues	**30,043**	**31,343**	**30,139**	**29,917**	**30,350**	**1.0%**
Communications	**29,131**	**30,365**	**29,152**	**28,845**	**29,244**	**0.4%**
Mobility	20,278	21,501	20,582	20,315	20,692	2.0%
Business Wireline	5,668	5,635	5,331	5,279	5,221	-7.9%
Consumer Wireline	3,185	3,229	3,239	3,251	3,331	4.6%
Latin America-Mexico	785	861	883	967	992	**26.4%**
Corporate and others	**127**	**117**	**104**	**105**	**114**	**-10.2%**
Adjusted EBITDA	10,714	10,231	10,589	11,053	11,203	4.6%
Communications	**11,173**	**10,835**	**11,032**	**11,490**	**11,623**	**4.0%**
Mobility	8,268	7,929	8,369	8,736	8,897	7.6%
Business Wireline	1,963	1,900	1,708	1,729	1,695	-13.7%
Consumer Wireline	942	1,006	955	1,025	1,031	9.4%
Latin America-Mexico	101	85	145	146	155	**53.5%**
Corporate/ eliminations	▲ 560	▲ 689	▲ 588	▲ 583	▲ 575	-----
Adjusted EBITDA Margin	**35.7%**	**32.6%**	**35.1%**	**36.9%**	**36.9%**	**1.2**
Communications	**38.4%**	**35.7%**	**37.8%**	**39.8%**	**39.7%**	**1.3**
Mobility	40.8%	36.9%	40.7%	43.0%	43.0%	2.2
Business Wireline	34.6%	33.7%	32.0%	32.8%	32.5%	-2.1
Consumer Wireline	29.6%	31.2%	29.5%	31.5%	31.0%	1.4
Latin America-Mexico	**12.9%**	**9.9%**	**16.4%**	**15.1%**	**15.6%**	**2.7**

Source: Company materials, Bloomberg; compiled by Daiwa.

Back Numbers

Industrials

Boeing	Maintains annual delivery guidance	2023/09/07
GE	Raised financial guidance for FY23	2023/08/02
Boeing	Near-term delivery delays	2023/05/19
Airbus	Growth momentum continues	2023/04/06
Boeing	Towards operations stability?	2023/02/24
GE	Positioned to drive further growth	2023/02/07
Boeing	An asset or a liability?	2022/11/24
GE	Planned spin-offs on track	2022/11/22
Boeing	Commercial deliveries below expectations	2022/09/02
GE	Aerospace remains the key growth driver	2022/08/10
GE	Aviation recovery continues	2022/06/16
Boeing	Limited impact from Russia-Ukraine conflict	2022/05/30
Keppel	Agreed on the combination of Keppel O&M and Sembcorp Marine	2022/05/10

Information Technology

Amazon	Capital investments to be lower in 2023	2023/08/24
Microsoft	Maintains a strong balance sheet	2023/08/14
Amazon	Retail business into red	2023/03/14
Apple	Another record-breaking year	2022/12/13
Microsoft	Excellent execution abilities	2022/09/09

Communication Services

AT&T	Old cables bring uncertainty	2023/09/20
Disney	Streaming losses are decreasing	2023/08/30
AT&T	CapEx requirements to remain high in 2023	2023/03/24
Disney	Record results at theme parks	2023/02/01
AT&T	On track to achieve the annual financial targets	2022/11/11
AT&T	Warning of the challenging operating environment	2022/08/09
AT&T	Exited media business	2022/05/26
Disney	Could Genie grant Disney's wish?	2022/02/14

Energy

US and European Energy Majors	Continue to deleverage	2023/06/12
US and European Energy Majors	Update on 3Q22 Results	2023/01/11
ExxonMobil	Record profits	2022/09/08
ExxonMobil	Recorded losses from Russia exit	2022/06/24

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- There is a risk that you will incur losses on your transactions due to changes in the market price of financial instruments based on fluctuations in interest rates, exchange rates, stock prices, real estate prices, commodity prices, and others. In addition, depending on the content of the transaction, the loss could exceed the amount of the collateral or margin requirements.
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** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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