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# AT&T (T) Update- 6/20 Qtr.
# Maintain BUY

**We are maintaining our BUY recommendation on AT&T. EPS of 83-cents down from 89-cents y/y still represents strong growth amid a longer period of COVID disruption in 1Q20. AT&T's adjusted 83-cents did not add back 9-cents of COVID issues.** That was 6-cents from lost revenue (lack of international roaming fees, not assessing late fees, lost advertising revenue without sports, and delayed movie releases) and 3-cents from higher costs (increased compensation and production delays). **AT&T also did not add back (and should not in our view) $400 million spent on the Roll-out of HBO Max. That is another 4-cents for roll-out. COVID and the HBO Max are 13-cents and are the difference in EPS being down 6-cents vs. up 7-cents**.

Of the adjustments from 17-cents in GAAP EPS to 83-cents, we know 29-cents was from writing off goodwill at Vrio in Latin America with FX charges sapping results. AT&T also adds back 24-cents of acquisition-related intangibles. We disagree with this policy as this amortization is an ongoing expense and it cost cash to begin with. It was a 21-cent adjustment in 2Q19, so leaving these out – the adjusted EPS declined by 9-cents y/y with a 9-cent COVID hit. Severance was the bulk of the rest of the adjustment at 10-cents and is part of the company's efforts to achieve $6 billion in cost savings by streamlining processes like distribution, closing some laggard AT&T stores, and going to more self-installation for AT&T TV.

**We are comfortable overall with the adjustments given what AT&T did not add back (HBO Max and COVID) and the other items do appear to be one-time in nature. The amortization impacts both quarters and isn't as pronounced as a 3-cent difference**. Other key takeaways are:

- Liquidity and cash flow remain strong. AT&T realized another $827 million from selling receivables and the "other" catch-all added $691 million in 2Q20 – which likely includes CARES Act funding. The company refinanced $17 billion in debt to shrink near-term debt maturities by $5-$6 million per year for 2020-22. Maturities are now only $5, $6, and $7 billion per year for the next three years. Even with the HBO Max roll-out and spending $1 billion more for 5G spectrum – Free Cash Flow came in at $7.6 billion vs. $8.8 billion the year before. The prior year had $1.5 billion from selling receivables too.

- Many of the lost revenue items seem likely to return. Eventually, sports will be shown on TV again and produce ad revenues. Movies will be shown again too and produce revenue. And roaming fees and late fees will also build back to normal levels. Based on the estimate of 6-cents of EPS – these are over $400 million of income and cash flow.

- Debt/EBITDA ticked up slightly to 2.6x as the lost COVID income helped lower Trailing 12 months EBITDA by about $1.5 billion. AT&T still expects to close on $2 billion in asset sales shortly and complete the sale of the Puerto Rico unit that should all reduce debt further. With the debt maturities only $5 billion this year, AT&T again affirmed its commitment to its growing dividend.

- Mobility grew EBITDA 1% y/y despite the loss of roaming and late fees. The reason we like AT&T remains this unit at 55% of total EBITDA is still growing. HBO Max showed some synergies here by bundling people with higher ARPU wireless plans. Churn was down for both post-paid and pre-paid accounts. They are seeing equipment sales rebound quickly as the stores reopened. Mobility should still have tailwinds from reduced costs as the stores, compensation, and distribution are modified. 5G and FirstNet should also add more customers. Plus, it should recover more of the roaming and late fees missing in the 2Q.

- WarnerMedia had a very good quarter under the circumstances in our view. EBITDA fell $319 million y/y, which is an improvement over 1Q decay. Movie theaters were closed for essentially the full quarter and Turner lost the NBA playoffs. Ad revenues at Turner were down $470 million. It also had HBO Max roll-out costs. Much lower programing costs at Turner (likely sports) helped the most. HBO added 3.25 million customers since the end of 1Q20. This unit may have the most upside from a return to normalcy.

- Entertainment continues to be the weak link as it trades lost customers for higher ARPU. This is most pronounced for TV where customer losses were another 886,000.

The company is pulling costs out of this unit by making AT&T TV a self-installed item and AT&T TV is performing well according to management and is heavily tied with its broadband. Still, no numbers are provided for this. The shedding of premium TV customers due to cheap lock-up deals rolling off may be over at this point. We still focus on TV as being a very minor part of total EBITDA – about 7% of EBITDA vs. Mobility at 55% and WarnerMedia at a depressed 15% now that is normally about 20%.

# Explanation of EQ Rating Scale

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| 6- "Exceptionally Strong" | Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises |
| 5- "Strong" | Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods. |
| 4- "Acceptable" | Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement |
| 3- "Minor Concern" | Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future. |
| 2- "Weak" | Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears. |
| 1- "Strong Concerns" | Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely. |

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

**Key Points to Understand About the EQ Score**

**The EQ Review Rating is much more than a blind, quantitative scoring method**. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

**The EQ Review Rating is not comparable to a traditional buy/sell rating**. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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