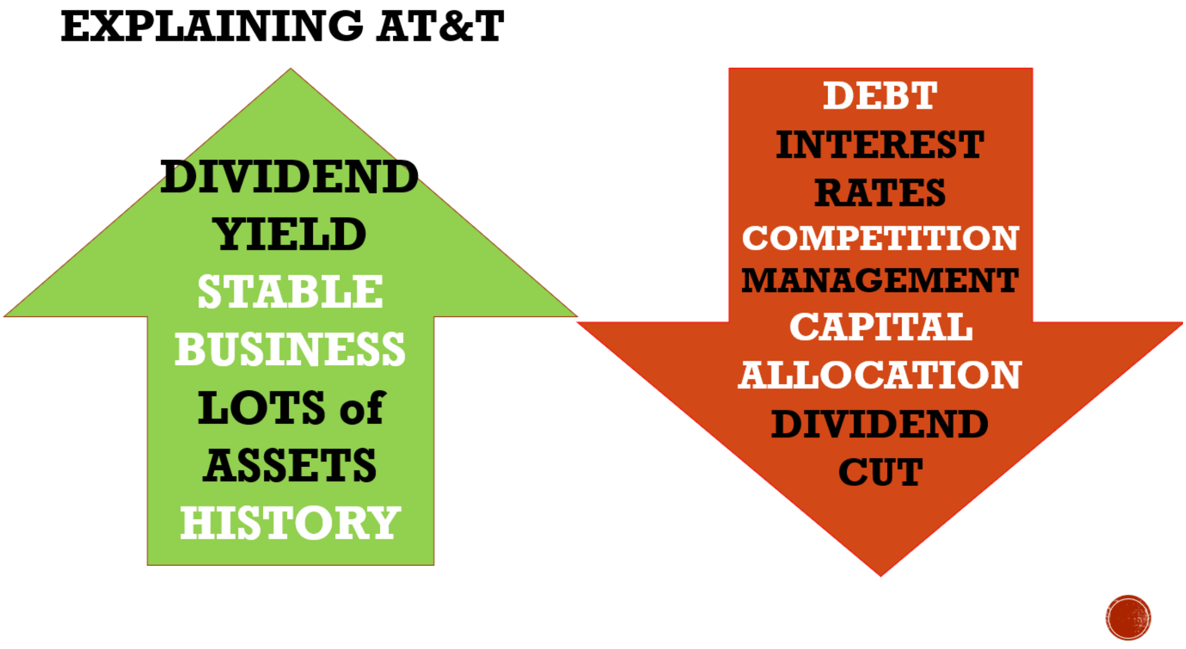
AT&T Stock Is Undervalued, but the debt is higher than what Finland has

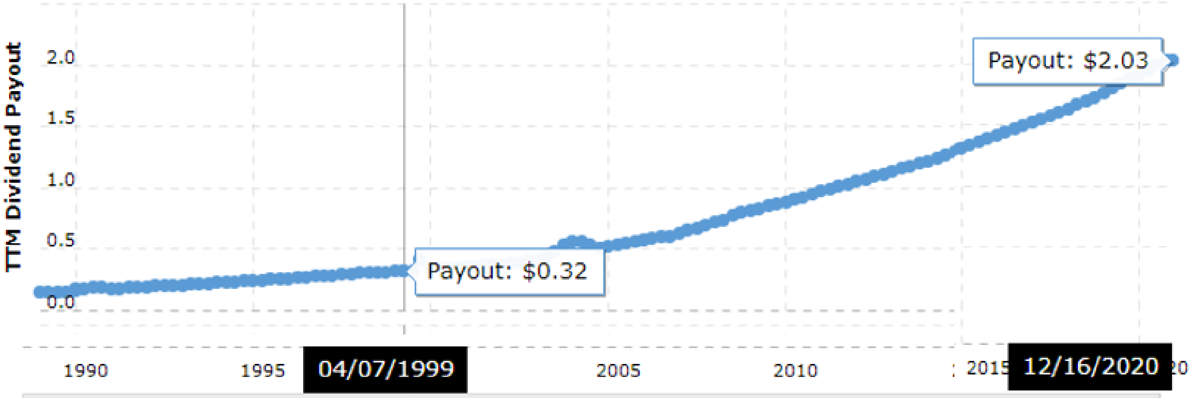


AT&T stock analysis

AT&T Stock Price Analysis – not going well

AT&T stock price historical chart

AT&T's stock price shows the risks of investing in something perceived as safe. On one hand, yes, the company has quadrupled its dividend over the past 15 years, but the stock price didn't really go anywhere and has been hit hard, especially over the last few years.



AT&T dividend growth – Source: [Macrotrends]

Over the last 5 years, AT&T's stock performance has been terrible, especially when compared to the S&P 500 that is up 78.54%.

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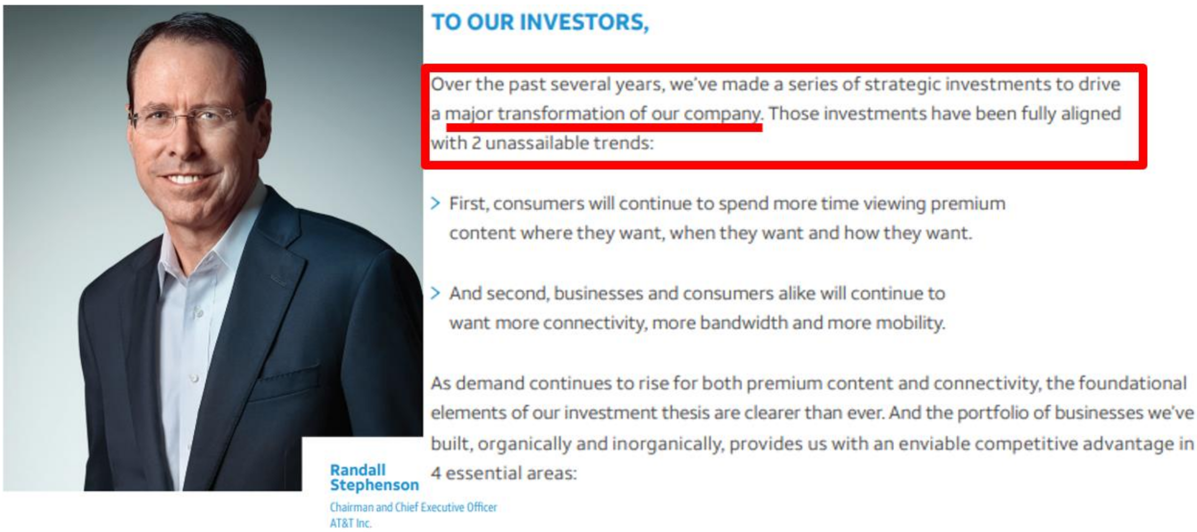
AT&T stock 5 years performance – Source: [AT&T quote CNN Money]

To me, the above shows the risks of investing in things that seem certain but really aren't. AT&T always looks like a company with a huge stable business that leads to a safe dividend and you always wonder why is the stock punished so hard, why is the yield so high and how the market is very wrong.

Well, it is also possible that the dividend is the just a tree, but the company is doing whatever it can to keep the tree in your focus (constantly increasing dividends over time) and not let you see the forest, the forest of debt in AT&T's case.

Plus, instead of sticking to things that are certain, the company constantly tries to please Wall Street, or greedy shareholders, and does [acquisitions] that don't really add much value to shareholders.

Further, the management is still working on transforming the company, implicitly saying that what had been done isn't really good.



TO OUR INVESTORS,

Over the past several years, we've made a series of strategic investments to drive a major transformation of our company. Those investments have been fully aligned with 2 unassailable trends:

> First, consumers will continue to spend more time viewing premium content where they want, when they want and how they want.

> And second, businesses and consumers alike will continue to want more connectivity, more bandwidth and more mobility.

As demand continues to rise for both premium content and connectivity, the foundational elements of our investment thesis are clearer than ever. And the portfolio of businesses we've built, organically and inorganically, provides us with an enviable competitive advantage in 4 essential areas:

Randall Stephenson
Chairman and Chief Executive Officer
AT&T Inc.

AT&T CEO message – Source: AT&T 2019 Annual Report

And there is no guarantee that the new transformations will be beneficial for shareholders. Creating a diversified telecom and media company sounds good, but it is risky, very risky. The problem with transformation strategies and big acquisitions is that most of those fail.

Harvard Business Review

Strategy | **Don't Make This Common M&A Mistake**

According to most studies, between 70 and 90 percent of acquisitions fail. Most explanations for this depressing number emphasize problems with integrating the two parties involved. That's perfectly true, but my experience suggests that integration problems are particularly severe in cases you wouldn't necessarily expect — when the acquisition is a related diversification, that is a "complementary" business, which the acquirer understands quite well. The case of Quadrant illustrates my observation.

Quadrant, not its real name, is a public company in the printing business with nearly 4,000 staff. It has a national footprint and its clients are companies and government departments which require large print runs of brochures, magazines, catalogues and marketing material. The company's share price had been on a gradual downward slide since it floated in 2008. In 2017 it stood at a quarter of its original price. Shareholders were hurting and directors were under pressure to act.

M&A failure facts – Source: [HRB](HRB)

But, if you are an investment banker, selling a M&A idea to a company like AT&T that has a slow revenue growth issue (1), declining net income (2) but high cash flows (3) that allow it to tap debt markets easily, it's easy as pie. In a world where the key is growth, the management is desperate to give the impression they are busy, working hard and growing, so they are desperate for acquisitions.

AT&T Inc T | ★★★★

Financials

Export Ascending

	2010-12	2011-12	2012-12	2013-12	2014-12	2015-12	2016-12	2017-12	2018-12	2019-12	TTM	
Revenue USD Mil	124,280	126,723	127,434	128,752	132,447	146,801	163,786	160,546	170,756	181,193	172,890	1
Gross Margin %	57.9	54.7	56.7	60.0	54.2	54.3	53.1	51.8	53.5	53.6	53.9	
Operating Income USD Mil	19,573	12,128	12,997	30,479	13,866	24,785	24,708	23,863	26,142	29,413	26,444	
Operating Margin %	15.7	9.6	10.2	23.7	10.5	16.9	15.1	14.9	15.3	16.2	15.3	
Net Income USD Mil	19,864	3,944	7,264	18,249	6,224	13,345	12,976	29,450	19,370	13,903	11,101	2
Earnings Per Share USD	3.35	0.66	1.25	3.42	1.24	2.37	2.10	4.76	2.85	1.89	1.51	
Dividends USD	1.69	1.73	1.77	1.81	1.85	1.89	1.93	1.97	2.01	2.05	2.08	
Payout Ratio % *	52.5	87.3	141.6	125.0	56.6	208.9	81.3	93.8	38.0	91.5	137.8	
Shares Mil	5,938	5,950	5,821	5,385	5,221	5,646	6,189	6,183	6,806	7,348	7,225	
Book Value Per Share * USD	18.89	19.17	16.55	16.40	17.86	19.83	20.14	20.35	25.25	25.23	24.64	
Operating Cash Flow USD Mil	34,993	34,648	39,176	34,796	31,338	35,880	39,344	39,151	43,602	48,668	44,991	
Cap Spending USD Mil	-19,530	-20,110	-19,465	-20,944	-21,199	-19,218	-21,516	-20,647	-20,758	-19,435	-16,875	
Free Cash Flow USD Mil	15,463	14,538	19,711	13,852	10,139	16,662	17,828	18,504	22,844	29,233	28,116	3
Free Cash Flow Per Share * USD	2.60	2.66	3.39	2.92	2.16	2.72	2.78	2.82	3.16	3.96	—	
Working Capital USD Mil	-14,000	-7,767	-9,081	-11,799	-5,254	-11,824	-12,207	-2,243	-12,993	-14,150	—	

* Indicates calendar year-end data information

AT&T revenue, net income and cash flows – Source: Morningstar

The problem with acquisition is that people forget how markets, economies, nature; actually, everything is cyclical. Therefore, most acquisitions are done in really good times when the buyer can find the money and the seller get a good price for his business. As Buffett puts it, the problems arise when the cycle turns and the horse starts limping again.

"In any case, why potential buyers even look at projections prepared by sellers baffles me. Charlie and I never give them a glance, but instead keep in mind the story of the man with an ailing horse.

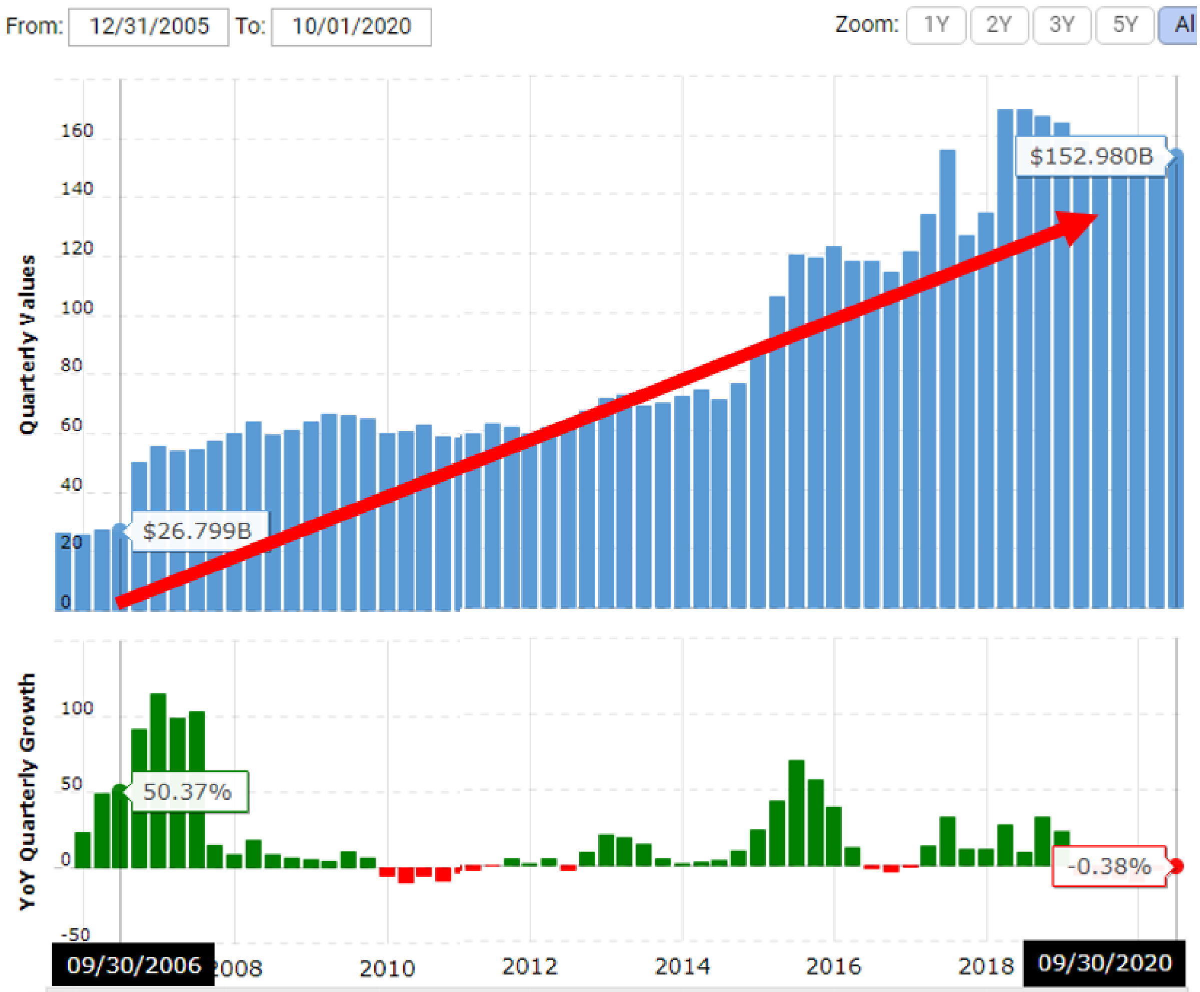
Visiting the vet, he said: "Can you help me? Sometimes my horse walks just fine and sometimes he limps."

The vet's reply was pointed: "No problem – when he's walking fine, sell him."

In the world of mergers and acquisitions, that horse would be peddled as Secretariat."

Buffett on acquisitions

Fortunately, AT&T has no plans to make new acquisitions in the coming 3 years, but you never know. Past acquisitions led to an inflating balance sheet where debt went from $27 billion in 2006 to the current $153 billion. (we are at $159 billion if I add the current portion of long-term debt)



AT&T long-term debt – Source: [Macrotrends AT&T]

The funny thing here is that if AT&T would be a country, it would be ranked 40th on the global debt level list.

Rank	Country	Debt to GDP	Gross Debt ($B)	% of World Total
#31	Sweden	38.5%	$214	0.3%
#32	Thailand	42.1%	$213	0.3%
#33	South Africa	56.7%	$209	0.3%
#34	Taiwan Province of China	35.1%	$207	0.3%
#35	Malaysia	55.6%	$199	0.3%
#36	Venezuela	182.4%	$180	0.3%
#37	Norway	40.0%	$174	0.3%
#38	Colombia	52.2%	$173	0.2%
#39	Finland	59.3%	$163	0.2%
#40	Saudi Arabia	19.0%	$149	0.2%
#41	Iran	32.2%	$144	0.2%
#42	Vietnam	55.6%	$134	0.2%
#43	Philippines	38.9%	$129	0.2%
#44	Denmark	34.3%	$121	0.2%
#45	Hungary	70.8%	$114	0.2%

AT&T

AT&T debt levels are similar to Finland and higher than Denmark – Source: Visual Capitalist

As A&T needs $14 billion to pay its dividend per year, and those numbers were lower over the last 10 years, we could say the company hasn't created any value since 2005 because when I divide the $125 billion increase in debt over the last 15 years, I get $8.3 billion. This means that the last 15 years of dividends have been financed by issuing debt.

I am sure AT&T can't continue like this for long and that is one of the negatives that is reflected in the current stock price. On the other hand, there have been acquisitions, investments etc. but with no revenue growth, you can only squeeze so much.

Consolidated Statements of Cash Flows
Dollars in millions

	2019	2018	2017
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	**(276)**	(821)	(2)
Issuance of other short-term borrowings	**4,012**	4,898	—
Repayment of other short-term borrowings	**(6,904)**	(2,098)	—
Issuance of long-term debt	**17,039**	41,875	48,793
Repayment of long-term debt	**(27,592)**	(52,643)	(12,339)
Payment of vendor financing	**(3,050)**	(560)	(572)
Issuance of preferred stock	**1,164**	—	—
Purchase of treasury stock	**(2,417)**	(609)	(463)
Issuance of treasury stock	**631**	745	33
Issuance of preferred interests in subsidiary	**7,876**	—	—
Dividends paid	**(14,888)**	(13,410)	(12,038)
Other	**(678)**	(3,366)	2,518
Net Cash (Used in) Provided by Financing Activities	**(25,083)**	(25,989)	25,930
Net increase (decrease) in cash and cash equivalents and restricted cash	**6,895**	(45,532)	44,997
Cash and cash equivalents and restricted cash beginning of year	**5,400**	50,932	5,935
Cash and Cash Equivalents and Restricted Cash End of Year	**$ 12,295**	$ 5,400	$ 50,932

The accompanying notes are an integral part of the consolidated financial statements.

AT&T dividend payments from cash flow statement - Source: AT&T 2019 Annual Report

AT&T's story is similar to the IBM story that we discussed here: IBM stock analysis. However, the above is the past and we must look into the future as the stock is low and might represent an opportunity.

AT&T stock analysis – business outlook

We don't have to spend much time on AT&T's business. There are 4 segments where the core of the business is still communications.

				Percent Change	
	2019	2018	2017	2019 vs. 2018	2018 vs. 2017
Operating Revenues					
Communications	**$142,359**	$143,721	$149,457	**(0.9)%**	(3.8)%
WarnerMedia	**33,499**	18,941	430	**76.9**	—
Latin America	**6,963**	7,652	8,269	**(9.0)**	(7.5)
Xandr	**2,022**	1,740	1,373	**16.2**	26.7
Corporate and other	**1,603**	2,101	2,200	**(23.7)**	(4.5)
Eliminations and consolidation	**(5,253)**	(3,399)	(1,183)	**(54.5)**	—
AT&T Operating Revenues	**181,193**	170,756	160,546	**6.1**	6.4
Operating Contribution					
Communications	**32,230**	32,108	31,488	**0.4**	2.0
WarnerMedia	**9,326**	5,695	62	**63.8**	—
Latin America	**(635)**	(710)	(266)	**10.6**	—
Xandr	**1,318**	1,333	1,202	**(1.1)**	10.9
Segment Operating Contribution	**$ 42,239**	$ 38,426	$ 32,486	**9.9%**	18.3%

AT&T financial business overview – Source: AT&T 2019 Annual Report

The company expects to see stable revenues in the future and to keep free cash flows at around $28 billion per year. Of those cash flows, the capital allocation plan is the following:

- $15 billion for dividends
- Remaining for share repurchases and debt retirement

$20

BILLION

We will continue to invest at top-tier levels. In 2020, we expect gross capital investment to be ~$20 billion.

Capital Allocation

A key element of our 3-year plan for 2020-2022 is our capital allocation framework.

First and foremost, we will continue to invest aggressively and at top-tier levels in our core businesses, and we expect our 2020 gross capital investment to be approximately $20 billion.

We'll also continue to grow our quarterly dividend, as we've done for 36 straight years – ever since I joined the company. We expect modest annual increases in our dividend and a dividend payout ratio as a percent of free cash flow below 50% in 2022. We finished 2019 with a payout ratio of 51%.[11]

Our focus over the next 3 years will be on retiring the common shares we issued to acquire Time Warner. After paying the dividend, we intend to use 50% to 70% of our free cash flow to retire about 70% of those shares. That's about 10% of our outstanding shares at the end of 2019. We retired about 56 million shares last year and will retire about 100 million shares in the first quarter of this year through a $4 billion accelerated share repurchase agreement.

"We'll continue to grow our quarterly dividend, as we've done for 36 straight years – ever since I joined the company."

AT&T capital allocation - Source: AT&T 2019 Annual Report

While reading the annual report I also found something interesting which is their focus on asset sales where the board dedicates immense amounts of time.

PORTFOLIO MANAGEMENT

We have a record of routinely pruning our portfolio of assets. And over the last few years, we've monetized more than $30 billion in assets, including those that do not contribute to our core strategy. And you can expect continued evaluation of our businesses and more progress in divesting assets that are no longer core to our fundamental mission. We have targeted the monetization of another $5-$10 billion of non-core assets in 2020.

This is a continuous process for us, and it is one of the areas to which our board of directors dedicates a tremendous amount of time and attention. With the support of our board generally, and the corporate development and finance committee in particular, we are well into the next review of our portfolio. We'll keep you updated on our progress as we have done over the past year.

We're committed to an objective, diligent and disciplined process. We'll analyze the merits of each of our businesses individually and as part of the whole.

AT&T capital allocation - Source: AT&T 2019 Annual Report

My thoughts here are that they are not focusing on organic growth, so in 3 years they will be bored again, the results of the previous acquisitions will not be stellar, revenues will start declining, cash flows too, and they will search for a new acquisition and there will be an investment bank that will deliver the idea for sure, and even do everything to find the money.

Before valuing the company, I have a problem with their expected free cash flows of $30 billion per year because I see them in the cash flow statement, but I can't find the $30 billion in asset sales monetization over the last few years. I can only find $4.6 billion in 2019 and $2.1 billion in 2018.

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We have a record of routinely pruning our portfolio of assets. And over the last few years, we've monetized more than $30 billion in assets, including those that do not contribute to our core strategy. And you can expect continued evaluation of our businesses and more progress in divesting assets that are no longer core to our fundamental mission. We have targeted the monetization of another $5-$10 billion of non-core assets in 2020.

AT&T asset sale monetization - Source: AT&T 2019 Annual Report

When it comes to what really matters when investing; how you reward shareholders or repay debt, in 2019 AT&T paid $15 billion for dividends, $2 billion for repurchases net of issuances and increased its cash position by $7 billion while lowering debt for $12 billion but also issuing preferred shares for $9 billion. So, after all the mumbo jumbo I get:

$15 dividends +$2 buybacks + $7 cash + $12 billion decrease in debt - $9 billion issuance of preferred shares = $27 billion which is in line with what the company says, but I miss the billions from the asset sales.

Consolidated Statements of Cash Flows
Dollars in millions

	2019	2018	2017
Operating Activities			
Net income	**$ 14,975**	$ 19,953	$ 29,847
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**28,217**	28,430	24,387
Amortization of film and television costs	**9,587**	3,772	—
Undistributed earnings from investments in equity affiliates	**205**	292	174
Provision for uncollectible accounts	**2,575**	1,791	1,642
Deferred income tax expense (benefit)	**1,806**	4,931	(15,265)
Net (gain) loss from sale of investments, net of impairments	**(1,218)**	(739)	(282)
Pension and postretirement benefit expense (credit)	**(2,002)**	(1,148)	(1,031)
Actuarial (gain) loss on pension and postretirement benefits	**5,171**	(3,412)	1,258
Asset abandonments and impairments	**1,458**	46	2,914
Changes in operating assets and liabilities:			
Receivables	**2,812**	(1,580)	(986)
Other current assets, inventories and theatrical film and television production costs	**(12,852)**	(6,442)	(778)
Accounts payable and other accrued liabilities	**(1,524)**	1,602	816
Equipment installment receivables and related sales	**548**	(490)	(1,239)
Deferred customer contract acquisition and fulfillment costs	**(910)**	(3,458)	(1,422)
Postretirement claims and contributions	**(1,008)**	(936)	(2,064)
Other – net	**738**	990	39
Total adjustments	**33,693**	23,649	8,163
Net Cash Provided by Operating Activities	**48,668**	43,602	38,010
Investing Activities			
Capital expenditures:			
Purchase of property and equipment	**(19,435)**	(20,758)	(20,647)
Interest during construction	**(200)**	(493)	(903)
Acquisitions, net of cash acquired	**(1,809)**	(43,309)	1,123
Dispositions	**4,684**	2,148	59
(Purchases), sales and settlement of securities and investments, net	**435**	(183)	449
Advances to and investments in equity affiliates	**(365)**	(1,050)	—
Cash collections of deferred purchase price	**—**	500	976
Net Cash Used in Investing Activities	**(16,690)**	(63,145)	(18,943)
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	**(276)**	(821)	(2)
Issuance of other short-term borrowings	**4,012**	4,898	—
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Source: AT&T 2019 Annual Report

By looking deeper, I found the explanation, the issuance of preferred shares is included in their cash flow calculation through the issuance of preferred shares. However, I still don't find the $30 billion the management discusses have been sold over the last years or $18 billion over 2019.

total capital, and reflects debt issuances, repayments and debt acquired in business combinations.

A significant amount of our cash outflows is related to tax items and benefits paid for current and former employees. Total taxes incurred, collected and remitted by AT&T during 2019 and 2018, were $24,170 and $22,172. These taxes include income, franchise, property, sales, excise, payroll, gross receipts and various other taxes and fees. Total health and welfare benefits provided to certain active and retired employees and their dependents totaled $4,059 in 2019, with $941 paid from plan assets. Of those benefits, $3,707 related to medical and prescription drug benefits. In addition, in 2019 we prefunded $500 for future benefit payments. During 2019, we paid $6,356 of pension benefits out of plan assets.

During 2019, we received $4,684 from the disposition of assets, and when combined with capital received from issuing preferred interests to external investors, an amendment of collateral arrangements, and working capital monetization initiatives, which include the sale of receivables, total cash received from monetization efforts, net of spectrum acquisitions, was approximately $18,000. We plan to continue to explore similar opportunities.

Source: AT&T 2019 Annual Report

So, yes, asset monetization improves the looks of the balance sheet, but the reality is that without that AT&T would have just enough for the dividend, buybacks and a bit of debt repayment which is an issue, a big one.

AT&T stock analysis fundamentals – the big debt issue

In total, when I add the debt and the future obligations that are debt, but called differently, I see $250 billion of debt obligations that the company will have to pay one day that is the main problem with AT&T. Comparing with countries again, the Russian government debt gets to $232 billion.

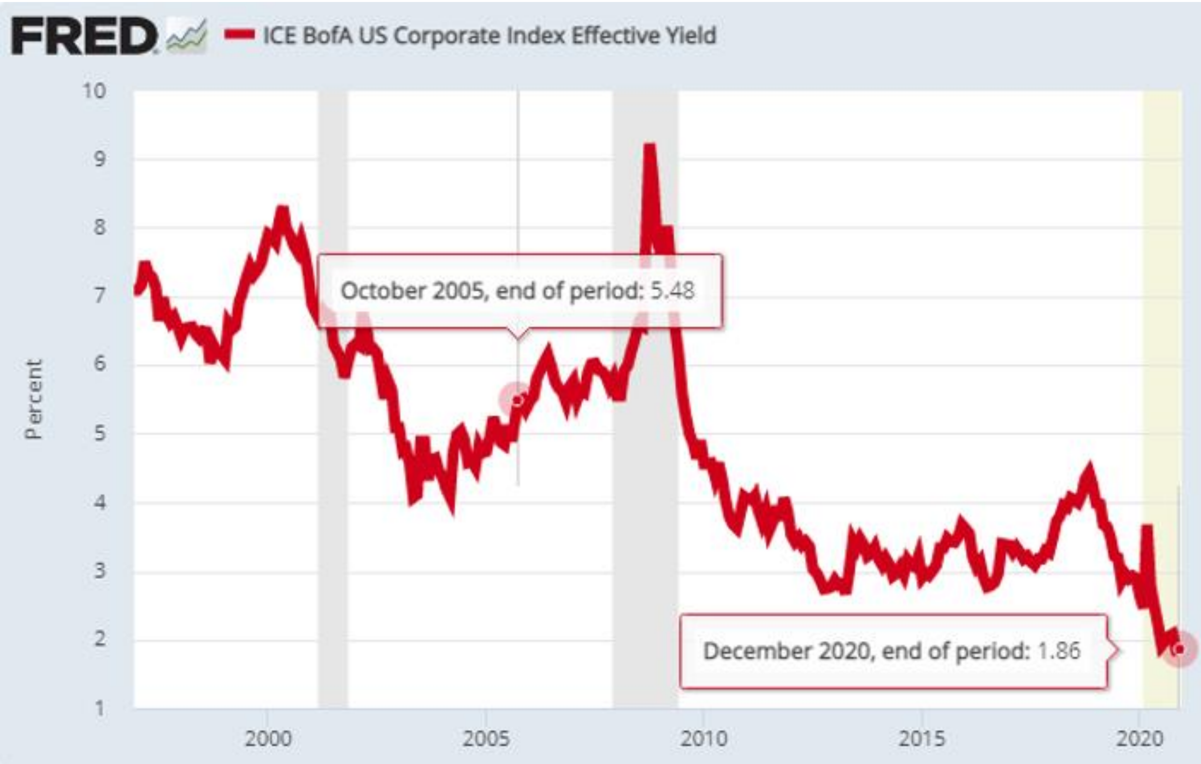
	September 30, 2020 (Unaudited)	December 31, 2019
Assets		
Current Assets		
Cash and cash equivalents	$ **9,758**	$ 12,130
Accounts receivable — net of related allowances for credit loss of $1,386 and $1,235	**19,379**	22,636
Prepaid expenses	**1,420**	1,631
Other current assets	**19,414**	18,364
Total current assets	**49,971**	54,761
Noncurrent Inventories and Theatrical Film and Television Production Costs	**13,948**	12,434
Property, plant and equipment	**333,797**	333,538
Less: accumulated depreciation and amortization	**(205,075)**	(203,410)
Property, Plant and Equipment — Net	**128,722**	130,128
Goodwill	**143,688**	146,241
Licenses — Net	**98,397**	97,907
Trademarks and Trade Names — Net	**23,575**	23,567
Distribution Networks — Net	**14,249**	15,345
Other Intangible Assets — Net	**17,523**	20,798
Investments in and Advances to Equity Affiliates	**2,325**	3,695
Operating Lease Right-Of-Use Assets	**24,546**	24,039
Other Assets	**21,609**	22,754
Total Assets	$ **538,553**	$ 551,669
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	$ **5,898**	$ 11,838
Accounts payable and accrued liabilities	**42,728**	45,956
Advanced billings and customer deposits	**5,862**	6,124
Accrued taxes	**1,336**	1,212
Dividends payable	**3,741**	3,781
Total current liabilities	**59,565**	68,911
Long-Term Debt	**152,980**	151,309
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	**60,448**	59,502
Postemployment benefit obligation	**17,928**	18,788
Operating lease liabilities	**22,056**	21,804
Other noncurrent liabilities	**30,520**	29,421
Total deferred credits and other noncurrent liabilities	**130,952**	129,515
Stockholders' Equity		
Preferred stock ($1 par value, 10,000,000 authorized):		
Series A (48,000 issued and outstanding at September 30, 2020 and December 31, 2019)	—	—
Series B (20,000 issued and outstanding at September 30, 2020 and 0 issued and outstanding at December 31, 2019)	—	—
Series C (70,000 issued and outstanding at September 30, 2020 and 0 issued and outstanding at December 31, 2019)	—	—
Common stock ($1 par value, 14,000,000,000 authorized at September 30, 2020 and December 31, 2019: issued 7,620,748,598 at September 30, 2020 and December 31, 2019)	**7,621**	7,621
Additional paid-in capital	**130,139**	126,279
Retained earnings	**55,094**	57,936
Treasury stock (495,703,331 at September 30, 2020 and 366,193,458 at December 31, 2019, at cost)	**(17,950)**	(13,085)
Accumulated other comprehensive income	**649**	5,470
Noncontrolling interest	**19,503**	17,713
Total stockholders' equity	**195,056**	201,934
Total Liabilities and Stockholders' Equity	$ **538,553**	$ 551,669

See Notes to Consolidated Financial Statements.

Q3 2020 AT&T balance sheet or should I call it debt sheet – Source: [AT&T SEC filings]

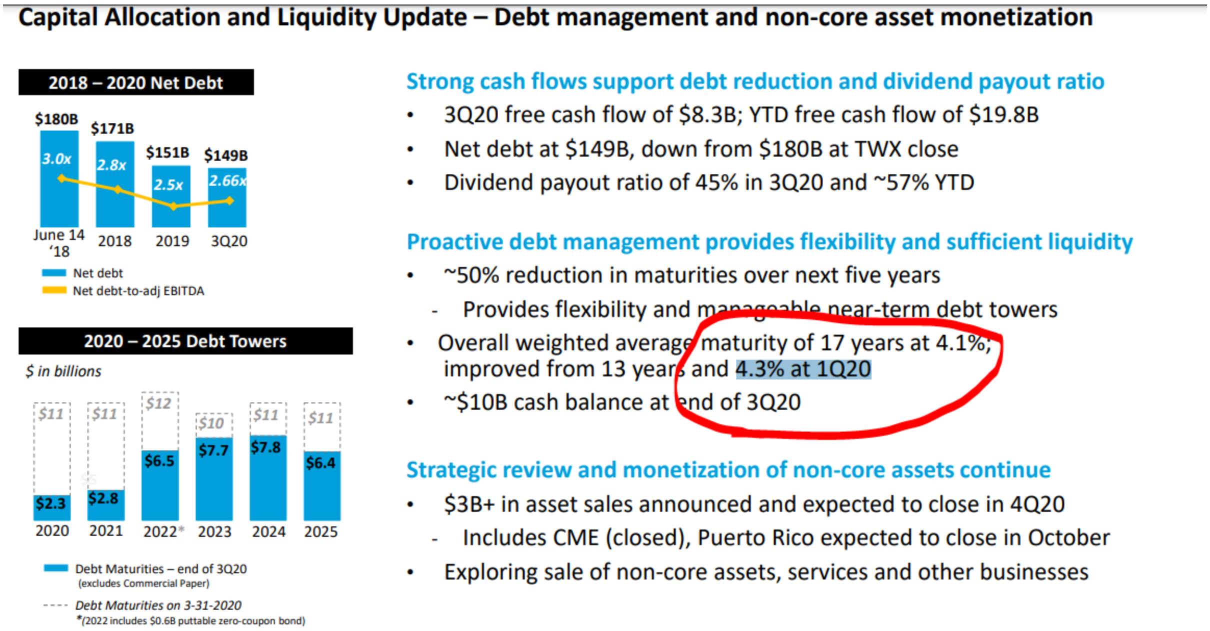
The problem is that if there is any kind of small slow down in the business, increased competition and free cash flows fall from $28 billion to let's say $25, AT&T would be in a pickle.

Keep in mind interest rates on debt are at historical lows. The US investment grade corporate bond yield is at 1.86% which is almost 400 basis points lower than in the 2000s.



ICE BofA US Corporate Index Effective Yield – Source: [FRED]

Imagine the hit to AT&T if interest rates would go up due to inflation. I believe inflation is already here but hasn't yet been acknowledge through statistics but the day will come, and then trouble will come. Given the competitiveness in AT&T's business, the constant fight for customers by racing to the bottom with prices, it is likely the company will not have much pricing power which means that debt costs and other costs would start going up while revenues would grow slower than inflation.



AT&T debt – Source: [AT&T]

Interest costs on $159 billion at 4.1% are $6.5 billion per year, if rates for AT&T spike, and that is something that can happen fast if bondholders panic, the whole historical AT&T behemoth could crumble under the weight of its debt.

With 'only' $25 billion in free cash flows, there would be only $10 billion left after paying the dividend, if $4 is spend on buybacks, $6 remains for other – on the $250 billion debt pile, it takes you 40 years to lower it or better to say never.

Plus, with $25 billion in cash flows, the free cash flow to debt pile is 10, that is a lot.

AT&T stock valuation and investment strategy

We have explained AT&T but let's see now how the above fits AT&T's current stock price.

AT&T

													Terminal Value	Growth rate	
Scenario 1	Cashflow 2020 billions		2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2030	-5%	next 5 years
worst case		28.00	26.60	25.27	24.01	22.81	21.67	19.50	17.55	15.79	14.21	12.79	99.50	-10%	5 to 10 years
in EUR	PV(10%)		24.18	20.88	18.04	15.58	13.45	11.01	9.01	7.37	6.03	4.93	38.36	10%	Discount rate
	INTRINSIC VALUE		168.84											7.0	Terminal multiple

													Terminal Value	Growth rate	
Scenario 2	Cashflow 2020 billions		2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2030	3%	next 5 years
best case		28.00	28.84	29.71	30.60	31.51	32.46	33.11	33.77	34.45	35.14	35.84	421.62	2%	5 to 10 years
in EUR	PV(10%)		26.22	24.55	22.99	21.52	20.15	18.69	17.33	16.07	14.90	13.82	162.55	10%	Discount rate
	Present value sum		358.80											12.0	Terminal multiple

													Terminal Value	Growth rate	
Scenario 3	Cashflow 2020 billions		2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2030	1%	next 5 years
normal case		28.00	28.28	28.56	28.85	29.14	29.43	29.72	30.02	30.32	30.62	30.93	275.61	1%	5 to 10 years
in EUR	PV(10%)		25.71	23.61	21.67	19.90	18.27	16.78	15.40	14.14	12.99	11.92	106.26	10%	Discount rate
	Present value sum		286.66											9.0	Terminal multiple

Scenario	Probability	PV	Part
Scenario 1 (worst case)	0.3	168.84	50.65
Scenario 2 (best case)	0.1	358.80	35.88
Scenario 3 (normal case)	0.6	286.66	172.00
		Sum	258.53

SVEN CARLIN RESEARCH PLATFORM

Disclaimer: This is just for educational purposes and not for investing advice!

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AT&T stock valuations – Source: Sven Carlin

With a 10% discount rate and a 30% chance of a bad scenario, 10% of a best scenario and a 60% chance for a normal scenario where revenue grows at 1% per year, I get a value for AT&T of $258 billion which puts AT&T, with the current market cap of $221 billion, in the undervalued basked.

However, the market might be more focused on the difficult possible times ahead. On thing is mathematics, the other is the market's perspective. If the worst-case scenario really happens, and cash flows decline significantly, bond holders might get scared, refinancing might become an issue involving asset sales (don't forget in crises you need to sell the gems), which could bring AT&T's market capitalization quickly down to $100 billion.

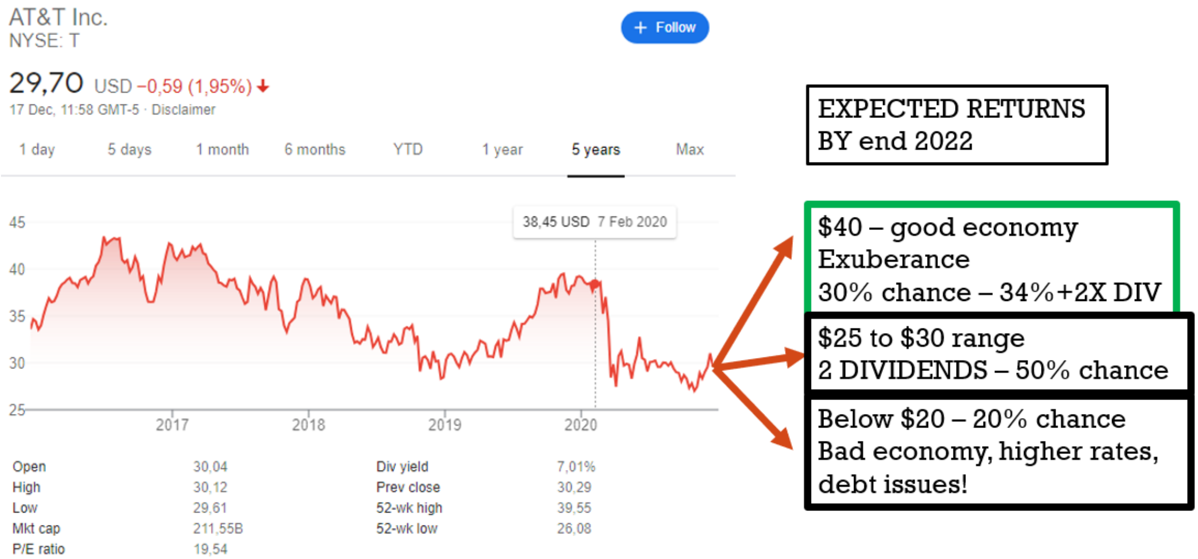
Plus, there are other risks like the USD for international investors where a currency depreciation might eliminate all the benefits of a strong dividend.

From my personal standpoint, I can find companies paying a 7% yield, growing 5% per year on top of the dividend, that have pricing power, natural moats and a debt to free cash flow of 1. So, I'll stick to those and not follow AT&T despite the fact that it is undervalued because for me, it is also important to sleep well when investing.

If you are long or consider going long AT&T, I agree on the undervaluation thesis, the high dividend and the strong cash flows produced by the business. However, given the debt pile, AT&T looks like a horse that sometimes walks just fine and sometimes limps.

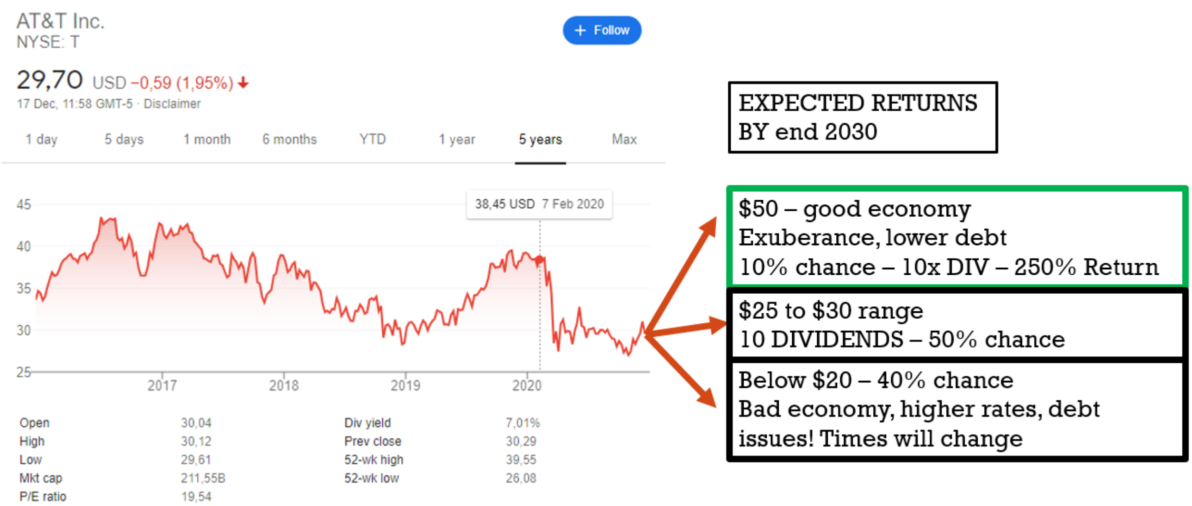
I think the horse is still limping currently as the stock price is below $30, so be sure to sell the stock when it looks like AT&T is walking just fine because, I am sure the horse will limp again in the future and perhaps even drop dead due to the huge debt in the long-term.

So, the short-term investing outlook would be the following and it is a positive risk reward proposition. The 7% dividend yield gives you a good return in case of things remaining as is, the positive upside is higher than the downside.



AT&T stock price forecast for the short term

On the long-term, I must say I am a bit more concerned because the probability of inflation is much higher while the competition for AT&T will only intensify and as the company is focused on selling assets, thus on a short-term perspective, the long-term outlook isn't good.



AT&T stock price forecast for the long-term

Yes, AT&T is undervalued but be sure to sell the horse when it is not limping.