

T Officially Pulls Plug on T-MO; Is DISH Next?

Largest Break-Up Fee in Corporate History Accompanies Formal End to Deal; DISH Spectrum Position May Be AT&T's Next Target

- AT&T officially pulled the plug on its ill-fated attempt to acquire T-Mobile USA tonight, following failure to receive regulatory approvals.
- AT&T had already announced a \$4 billion 4Q11 charge (which includes \$3 billion in cash and \$1 billion related to the book value of AWS spectrum) to account for the negotiated break-up fee. The break-up fee also includes a long-term roaming agreement.
- Speculation will now certainly turn to AT&T's next move to get its hands on spectrum. Although we have no knowledge of M&A discussions between the two parties, DISH/EchoStar could very well be the next target for AT&T, in our view.
- Assuming AT&T's acquisition of Qualcomm's spectrum is approved (with conditions likely), one major stumbling block to a DISH acquisition could very well be a waiver requested by DISH in its proposed takeover of 40 MHz of DBSD and TerreStar mobile satellite (MSS) spectrum, which could come soon. DISH is seeking an FCC waiver from an ATC (ancillary terrestrial component) "integrated service requirement" so it doesn't have to build dual-mode satellite/terrestrial capabilities into all its phones/devices. But there is some concern that if DISH gains that right, it could reap a "windfall" by flipping the spectrum/license to another party for a gain. DISH has denied that charge, saying it fully intends to invest substantial further capital (beyond the \$2.8bn already committed for the acquisitions) to deploy and operate a nationwide satellite/terrestrial network.
- The "windfall" issue could presumably be avoided with a "clawback" provision, making DISH or any DISH-acquirer pay the difference between the value of the spectrum today and any future adjacent AWS spectrum valuation achieved in an upcoming auction.
- DISH's spectrum, in the 700 MHz band, could be paired with Qualcomm's spectrum to give the company a clean 12 MHz unpaired block of spectrum. However, AT&T could also use DISH's 2 GHz MSS spectrum, if the FCC waiver is granted, as it also needs spectrum outside of the 700 MHz band to avoid interference with the company's burgeoning LTE network.

I N C O M E L I S T

Changes	Previous	Current
Rating	—	Buy
Target Price	—	\$32.50
FY11E EPS (Net)	—	\$2.35
FY12E EPS (Net)	—	\$2.52
FY11E Rev (Net)	—	\$126.17B
FY12E Rev (Net)	—	\$128.08B

Price (12/19/11):	\$28.74
52-Week Range:	\$32 – \$27
Market Cap.(mm):	170,486
Shr.O/S-Diluted (mm):	5,932.0
Enterprise Val. (mm):	\$230,261.0
Avg Daily Vol (3 Mo):	28,941,004
LT Debt/Total Cap.:	27.9%
Net Cash/Share:	\$0.00
Dividend(\$ / %)	\$1.72 / 6.0%
S&P Index	1,205.35

EPS (Net)	2010A	2011E	2012E
Q1	\$0.59	\$0.57A	\$NE
Q2	0.61	0.60A	NE
Q3	0.54	0.61A	NE
Q4	0.55	0.57	NE
FY Dec	\$2.29A	\$2.35	\$2.52
P/E	12.6x	12.2x	11.4x

Rev (Net)	2010A	2011E	2012E
FY Dec	\$124.28B	\$126.17B	\$128.08B
EV/Revenue	1.9x	1.8x	1.8x

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- While it certainly remains a possibility that AT&T could try to buy DISH's spectrum without buying the entire company, we believe Charlie Ergen realizes he is unlikely to ever get a better offer than from a moderately-desperate AT&T that needs spectrum and needs it quickly, and with the satellite TV industry's long-term business model being more uncertain than ever, we believe it more likely that AT&T will be forced to buy the entire company.
- If an AT&T-DISH merger is forthcoming, we would guess it would come sooner rather than later, to assure the FCC would be approving both the recent Verizon Wireless-Cable MSO spectrum transaction and the AT&T-DISH deal simultaneously. It would represent an opportunity for the Commission to obtain strong commitments for LTE build-outs, along with wholesale access conditions from the two largest operators in the U.S, to allow competitors greater opportunities.
- AT&T has even more reason now to push Congress to pass legislation to mandate more spectrum auctions, preferably including the House provisions to bar unlicensed uses of re-purposed broadcast spectrum and to restrict FCC authority to limit auction eligibility or to impose net neutrality and wholesale access duties.
- We believe the formal announcement of the break-up of the deal will be modestly positive tomorrow for Sprint Nextel (S: Hold, \$2.16), tower companies, and independent carriers. However, we note the formal death-knell of the deal has largely been expected for weeks.

Target Price Methodology/Risks

Our target price of \$32.50 is 5.6x our 2012 EBITDA forecast. Risks to our target price include macroeconomic pressures, which could materially impact the company's revenues and cash flows, and competitive pricing pressures in the company's wireline, wireless, and enterprise segments.

Company Description

AT&T Inc. is a premier communications holding company. Its subsidiaries and affiliates - AT&T operating companies - are the providers of AT&T services in the United States and around the world. With a powerful array of network resources that includes the nation's fastest mobile broadband network, AT&T is a leading provider of wireless, Wi-Fi, high speed Internet and voice services. A leader in mobile broadband, AT&T also offers the best wireless coverage worldwide, offering the most wireless phones that work in the most countries. It also offers advanced TV services under the AT&T U-verse(R) and AT&T DIRECTV brands. The company's suite of IP-based business communications services is one of the most advanced in the world. In domestic markets, AT&T Advertising Solutions and AT&T Interactive are known for their leadership in local search and advertising. In 2010, AT&T again ranked among the 50 Most Admired Companies by FORTUNE(R) magazine.

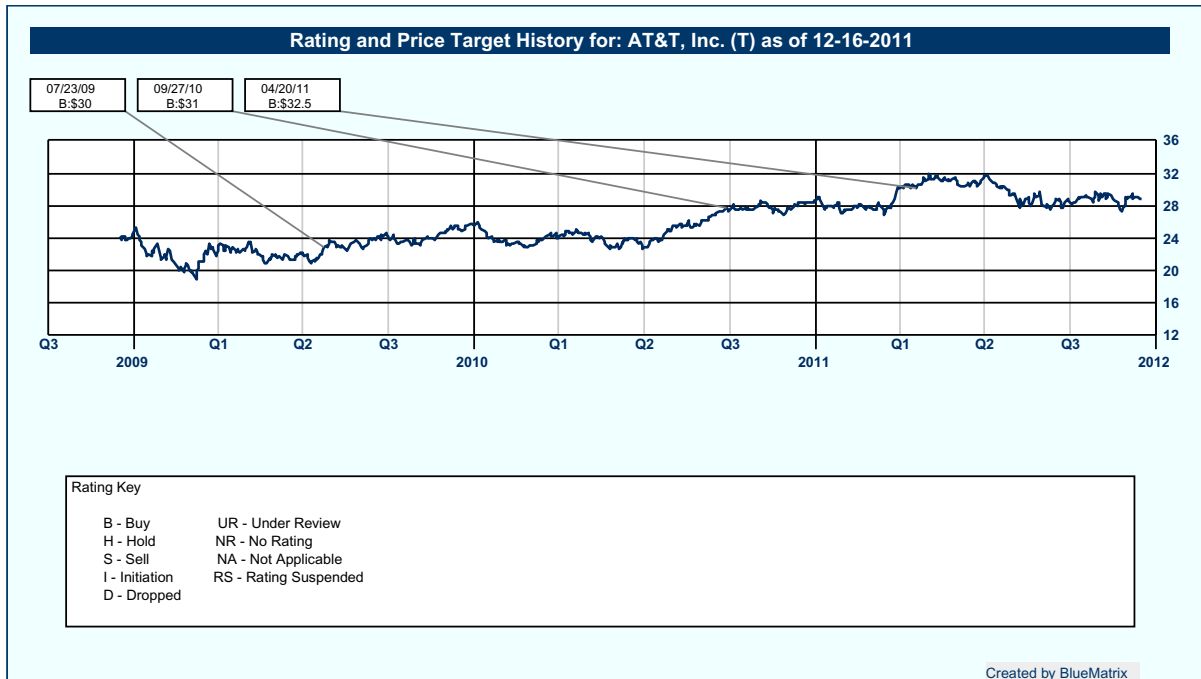
AT&T Earnings Model (T)
 (\$s in millions except per share data)

	FY 2009A	Q1 2010A	Q2 2010A	Q3 2010A	Q4 2010A	FY 2010A	Q1 2011A	Q2 2011A	Q3 2011A	Q4 2011E	FY 2011E	FY 2012E
Income Statement												
Operating Revenues												
Wireline	63,512	15,446	15,422	15,304	15,128	61,300	14,950	14,935	14,961	14,816	59,662	58,302
Wireless	53,504	13,897	14,242	15,180	15,181	58,500	15,309	15,602	15,606	16,245	62,762	66,608
Advertising solutions	4,724	1,041	1,007	961	926	3,935	868	841	803	778	3,290	2,763
Other	771	146	137	136	126	545	120	117	108	107	452	407
Total Operating Revenues	122,511	30,530	30,808	31,581	31,361	124,280	31,247	31,495	31,478	31,946	126,166	128,080
% growth (y-o-y)	-0.8%	0.2%	0.6%	2.6%	2.1%	1.4%	2.3%	2.2%	-0.3%	1.3%	1.5%	1.5%
Operating Expenses												
Cost of services	50,571	12,369	12,420	13,577	13,897	52,263	13,403	13,332	13,165	14,141	54,041	51,537
Selling, general & administrative	31,427	7,410	7,486	7,700	10,469	33,065	7,452	7,396	7,460	7,285	29,593	29,925
Depreciation & amortization	19,515	4,780	4,819	4,873	4,907	19,379	4,584	4,602	4,618	4,655	18,459	19,023
Total Operating Expenses	101,513	24,559	24,725	26,150	29,273	104,707	25,439	25,330	25,243	26,081	102,093	102,148
Operating Income	20,998	5,971	6,083	5,431	2,088	19,573	5,808	6,165	6,235	5,866	24,074	25,932
Interest expense	3,368	765	754	729	746	2,994	846	848	889	887	3,470	3,486
Equity in net income of affiliates	734	217	195	217	133	762	249	207	193	250	899	944
Other income (expense), net	152	(22)	723	124	72	897	59	27	46	25	157	0
Income b/f income taxes	18,516	5,401	6,247	5,043	1,547	18,238	5,270	5,551	5,585	5,253	21,659	23,390
Income taxes	6,091	2,863	2,160	(6,573)	388	(1,162)	1,802	1,893	1,899	1,812	7,406	8,186
Effective tax rate (%)	32.9%	53.0%	34.6%	-130.3%	25.1%	-6.4%	34.2%	34.1%	34.0%	34.5%	34.2%	35.0%
Net income	12,425	2,538	4,087	11,616	1,159	19,400	3,468	3,658	3,686	3,441	14,253	15,203
Less: Income (Loss) from disc. Ops.	20	2	(5)	780	2	779	0	0	0	0	0	0
Less: Net income attributable to noncontrolling interest	(309)	(87)	(79)	(77)	(72)	(315)	(60)	(67)	(63)	(63)	(253)	(252)
Net income attributable to AT&T	12,116	2,453	4,003	12,319	1,089	19,864	3,408	3,591	3,623	3,378	14,000	14,951
Diluted EPS attributable to AT&T	\$2.05	\$0.42	\$0.68	\$2.08	\$0.18	\$3.36	\$0.57	\$0.60	\$0.61	\$0.57	\$2.35	\$2.52
One-time charge (credit)		995	(400)	(9,100)	2,150		0	0	0			
Adjusted diluted EPS attributable to AT&T	\$2.05	\$0.59	\$0.61	\$0.54	\$0.55	\$2.29	\$0.57	\$0.60	\$0.61	\$0.57	\$2.35	\$2.52
Weighted Avg. Diluted Shares Outstanding	5,911	5,909	5,909	5,910	5,911	5,910	5,945	5,932	5,954	5,930	5,940	5,930
Cash Flow												
Operating Cash Flow (EBITDA)	40,513	10,751	10,902	10,304	10,458	42,415	10,392	10,767	10,853	10,520	42,532	44,956
% margin	33.1%	35.2%	35.4%	32.6%	33.3%	34.1%	33.3%	34.2%	34.5%	32.9%	33.7%	35.1%
Less: Cash interest	3,368	765	754	729	746	2,994	846	848	889	887	3,470	3,486
Less: Cash taxes	6,091	2,863	2,160	(6,266)	388	(1,162)	1,802	1,893	1,899	1,812	7,406	8,186
Less: Capex	17,335	3,340	4,904	5,512	6,555	20,311	4,133	5,314	5,314	5,431	20,192	20,493
% of revenues	14.1%	10.9%	15.9%	17.5%	20.9%	16.3%	13.2%	16.9%	16.9%	17.0%	16.0%	16.0%
Free Cash Flow b/f Dividends	13,719	3,783	3,084	4,689	2,769	14,325	3,611	2,712	2,751	2,390	11,464	12,790
Dividends paid	9,672	2,479	2,481	2,476	2,476	9,912	2,540	2,542	2,545	2,479	10,106	9,916
Free Cash Flow post Dividends	4,047	1,304	603	2,213	293	4,413	1,071	170	206	(89)	1,358	2,874
Balance Sheet												
Total debt (including current portion)	72,081	69,461	69,998	68,966	66,167	66,167	65,028	66,573	71,226	70,726	70,726	68,726
Cash and equivalents	3,802	2,617	1,377	3,246	1,437	1,437	1,391	3,831	10,762	10,173	10,173	11,047
Net debt	68,279	66,844	68,621	65,720	64,730	64,730	63,637	62,742	60,464	60,553	60,553	57,679
Shareholder's equity	102,325	102,466	103,483	113,293	112,425	112,425	112,843	114,109	113,882	114,844	114,844	120,131
Net PP&E	100,093	99,360	100,302	102,466	103,963	103,963	103,369	104,606	105,786	105,786	105,786	105,686
Long-term Debt												
Ending debt balance (including current portion)	72,081	69,461	69,998	68,966	66,167	66,167	65,028	66,573	71,226	70,726	70,726	68,726
Average debt	74,318	70,771	69,730	69,482	67,567	69,387	65,598	65,801	68,900	70,976	67,818	69,726
Interest expense	3,368	765	754	729	746	2,994	846	848	889	887	3,470	3,486
Effective interest rate	4.5%	4.3%	4.3%	4.2%	4.4%	4.3%	5.2%	5.2%	5.2%	5.0%	5.1%	5.0%
Leverage Ratios:												
Total debt/EBITDA	1.78x	1.62x	1.61x	1.67x	1.58x	1.56x	1.56x	1.55x	1.64x	1.68x	1.66x	1.53x
Net debt/EBITDA	1.69x	1.55x	1.57x	1.59x	1.55x	1.53x	1.53x	1.46x	1.39x	1.44x	1.42x	1.28x
D&A	19,515	4,780	4,819	4,873	4,907	19,379	4,584	4,602	4,618	4,655	18,459	19,023
% of net PP&E	19.5%	4.8%	4.8%	4.8%	4.7%	18.6%	4.4%	4.4%	4.4%	4.4%	17.4%	18.0%

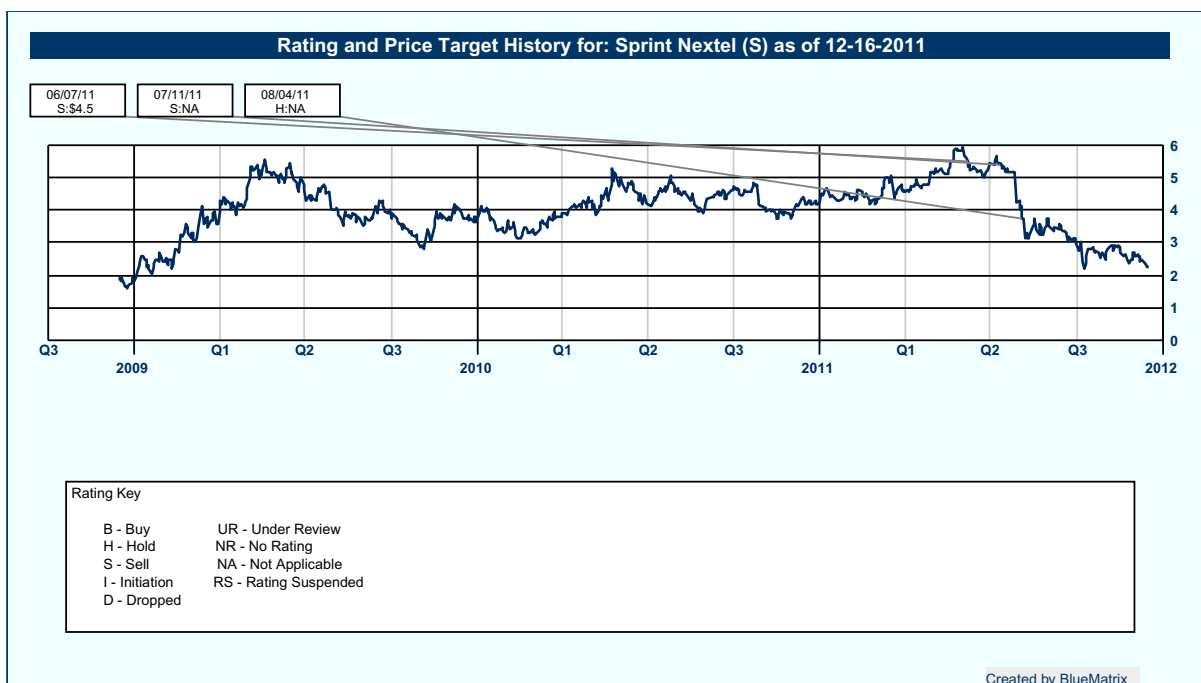
Source: Company data and Stifel Nicolaus estimates

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