AT&T Inc.

INVESTMENT SUMMARY

AT&T generates tens of billions of dollars of cash annually as one of the unquestioned leaders in the U.S. telecommunications industry. The company has diversified its operations from just a wireless and wireline provider of phone and data communications to include a large pay-TV presence (primarily from the acquisition of DIRECTV) and into media by acquiring content provider Time Warner. In our opinion, the company's competitive positioning, robust network and strong cash flows will enable it to remain a leader for the foreseeable future, albeit in a very competitive industry. In our view, AT&T is a sound corporate credit with the ability to meet its current and future debt obligations.

BOND OVERVIEW

Despite an increase in debt due to the acquisitions of DIRECTV and Time Warner, AT&T's financial position is adequate and currently improving, in our view. AT&T's debt balance grew significantly with its acquisitions of DIRECTV and Time Warner. The company faced multiple credit-rating agency downgrades due to this additional debt. However, the company is currently executing a plan to pay down debt and improve its financial position. AT&T plans to reduce debt by using the proceeds from the sale of noncore assets and by using the significant free cash flow (the remaining cash generated from operations after paying for maintenance and improvement of its assets) that the company generates.

Despite our view that the evolving telecom industry has become more competitive, market leaders like AT&T tend to have relatively stable cash flows that can be relied upon to support debt service. Stability of cash flow is an important characteristic in determining how creditworthy a corporation is. The telecom industry and AT&T tend to have strong stability of cash flow, meaning that in an economic downturn, we would expect to see minimal impact on the cash AT&T generates relative to the average company across industries. This small impact is indicative of the importance of services the company offers, including wireless telecom and home Internet. These tend to be services customers retain even in a relatively severe economic downturn. This stable cash flow makes paying interest and principal on debt more manageable and decreases risk for bondholders relative to a company that has a less stable cash flow profile.

An activist investor has taken a stake in AT&T with the goal of improving its stock price. Elliott Management has reported that it owns slightly over a 1% stake in AT&T.

While thoughts of an “activist investor” entering a company can sometimes strike fear in bondholders, we believe Elliott’s plan is essentially neutral overall to bondholders. While the investor does advocate for an increase in share repurchases, it also recognizes the importance of continuing to improve AT&T’s financial position after it took on debt to purchase Time Warner. Elliott indicates it believes AT&T should continue to pay down debt. The investor also focuses on strategic decisions that have been made historically and asks the company to do no more major acquisitions while also considering selling various noncore assets.

In response to Elliott Management’s plan to improve operations at AT&T, the company announced a three-year plan to do so. The plan overall is quite consistent with what the activist investor had suggested including cost cutting, continued debt reduction, and share repurchases. Importantly, AT&T also agreed to no further major acquisitions in the next few years. Overall, we view this plan as relatively neutral to credit quality. Somewhat increased expectations for share repurchases at the expense of somewhat less debt reduction than previously contemplated is negative for bondholders. However, we believe the improvement in operations via efficiency and cost cutting is positive. Additionally, we think the pause on large acquisitions is a meaningful positive for credit quality because AT&T has been quite acquisitive recently. Acquisitions are often negative for credit quality, and we believe AT&T’s purchase of DIRECTV and its terminated acquisition of T-Mobile were both meaningfully negative for the company overall.
### Required Research Disclosures

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<th>Corporate Credits</th>
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The table lists the percent of corporate credits we follow globally in each of the equivalent rating categories. We do not assign a "Buy" rating to any corporate credits. Investment banking services indicate the percentage of those subject companies that have been investment banking clients within the last 12 months.

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<th>Appropriate for Income</th>
<th>Appropriate for Aggressive Income</th>
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<td>Appropriate for Income – We consider bonds to be an appropriate holding for investors seeking income within a well-diversified portfolio. Our time horizon is 3-5 years.</td>
<td>Appropriate for Aggressive Income – We consider bonds appropriate only as a small Aggressive Income portion within a well-diversified portfolio. Bonds within this category are riskier, with a higher possibility of loss due to default, than bonds classified as Income. Our time horizon is 3-5 years.</td>
<td>Sell – We recommend investors sell these bonds. We believe these bonds are no longer an appropriate fixed-income holding because, in our opinion, they offer an unattractive risk/reward scenario at current prices. Our time horizon is 3-5 years.</td>
<td>FYI - For informational purposes only; factual, no opinion.</td>
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