

Fast follower on wireless pricing

AT&T quickly follows Verizon Wireless price cut

On the heels of Verizon's price refresh announced Friday morning, AT&T responded with new pricing of its own Friday afternoon largely mirroring Verizon's moves. AT&T's rapid action recalls its response to Verizon's introduction of high end unlimited plans in February 2008 which occurred within 24 hours of the Verizon announcement. AT&T's high end unlimited wireless plan is now \$120 per month down from \$150 for smartphones including the iPhone. AT&T and Verizon seem to be following the same strategy, lowering ARPU immediately for a small, high end percentage of the base but likely raising ARPU over time within the middle market, a much larger percentage of the total.

Spotlight now on struggling operators

In our view, Verizon's move to lower high end pricing and raise mid-tier pricing must have anticipated AT&T's response given the broadside attack it represented and AT&T's past history of response. The focus now then is on who, beyond Verizon's own customers, was the real target of the move. The answer would appear to be Sprint, which among the laggard national providers has worked the hardest to cultivate a higher end clientele with its Simply Everything plan and which has led the market down with its Any Mobile, Anytime, mid-tier plan. We would not expect a quick reaction from Sprint given its industry-low service margin, recent price moves in the fall, and likely desire to evaluate the 1Q impact of these AT&T and Verizon moves.

Estimates (Dec)

(US\$)	2007A	2008A	2009E	2010E	2011E
EPS	1.94	2.16	2.12	2.26	2.54
GAAP EPS	1.94	2.16	2.12	2.26	2.54
EPS Change (YoY)	18.3%	11.3%	-1.9%	6.6%	12.4%
Consensus EPS (Bloomberg)			2.12	2.24	2.48
Dividend Rate	1.43	1.61	1.64	1.68	1.72

Valuation (Dec)

	2007A	2008A	2009E	2010E	2011E
P/E	13.3x	11.9x	12.2x	11.4x	10.2x
GAAP P/E	13.3x	11.9x	12.2x	11.4x	10.2x
Dividend Yield	5.6%	6.2%	6.4%	6.5%	6.7%
EV / EBITDA*	6.0x	6.0x	6.3x	6.0x	5.7x
Free Cash Flow Yield*	10.7%	8.8%	11.0%	12.3%	11.9%

* For full definitions of *iQmethod*SM measures, see page 7.

Equity | United States | Telecom Services-Wireline
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Stock Data

Price	US\$25.79
Price Objective	US\$30.00
Date Established	5-Jan-2009
Investment Opinion	A-2-7
Volatility Risk	LOW
52-Week Range	US\$21.44-28.73
Mrkt Val / Shares Out (mn)	US\$152,161 / 5,900.0
BofAML Ticker / Exchange	T / NYS
Bloomberg / Reuters	T US / T.N
ROE (2009E)	12.7%
Total Dbt to Cap (Sep-2009A)	42.1%
Est. 5-Yr EPS / DPS Growth	5.3% / 2.2%

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Refer to important disclosures on page 8 to 10. Analyst Certification on Page 6. Price Objective Basis/Risk on page 6.

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iQprofileSM AT&T Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2007A	2008A	2009E	2010E	2011E
Return on Capital Employed	5.4%	6.0%	5.9%	6.2%	6.8%
Return on Equity	10.4%	12.2%	12.7%	13.1%	14.2%
Operating Margin	17.2%	18.6%	17.9%	19.2%	21.1%
Free Cash Flow	16,355	13,321	16,687	18,787	18,130

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2007A	2008A	2009E	2010E	2011E
Cash Realization Ratio	2.9x	2.6x	2.7x	2.7x	2.4x
Asset Replacement Ratio	0.8x	1.0x	0.9x	0.9x	0.9x
Tax Rate	34.3%	35.4%	34.2%	36.0%	36.0%
Net Debt-to-Equity Ratio	63.4%	84.4%	78.4%	73.3%	70.9%
Interest Cover	5.8x	6.8x	6.5x	7.1x	7.6x

Income Statement Data (Dec)

(US\$ Millions)	2007A	2008A	2009E	2010E	2011E
Sales	118,928	124,028	123,143	125,425	128,033
% Change	1.6%	4.3%	-0.7%	1.9%	2.1%
Gross Profit	72,873	74,360	72,969	75,019	77,555
% Change	2.8%	2.0%	-1.9%	2.8%	3.4%
EBITDA	43,909	43,939	41,758	43,658	46,150
% Change	8.6%	0.1%	-5.0%	4.5%	5.7%
Net Interest & Other Income	(2,200)	(3,160)	(2,990)	(3,157)	(3,397)
Net Income (Adjusted)	11,951	12,867	12,549	13,383	15,094
% Change	16.0%	7.7%	-2.5%	6.6%	12.8%

Free Cash Flow Data (Dec)

(US\$ Millions)	2007A	2008A	2009E	2010E	2011E
Net Income from Cont Operations (GAAP)	11,951	12,867	12,549	13,383	15,094
Depreciation & Amortization	21,577	19,883	19,695	19,590	19,168
Change in Working Capital	0	0	20	(321)	(172)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	544	906	1,775	3,874	1,964
Capital Expenditure	(17,717)	(20,335)	(17,352)	(17,739)	(17,925)
Free Cash Flow	16,355	13,321	16,687	18,787	18,130
% Change	-18.1%	-18.6%	25.3%	12.6%	-3.5%

Balance Sheet Data (Dec)

(US\$ Millions)	2007A	2008A	2009E	2010E	2011E
Cash & Equivalents	1,970	1,792	1,197	5,729	6,682
Trade Receivables	16,678	16,047	15,279	15,610	16,006
Other Current Assets	6,093	4,717	5,208	5,208	5,208
Property, Plant & Equipment	95,890	99,088	100,729	105,086	108,951
Other Non-Current Assets	155,923	143,601	141,468	138,612	136,695
Total Assets	276,554	265,245	263,882	270,246	273,541
Short-Term Debt	11,015	8,139	7,436	7,027	5,907
Other Current Liabilities	21,399	20,032	19,284	19,294	19,518
Long-Term Debt	64,115	74,991	72,664	74,995	78,102
Other Non-Current Liabilities	64,658	65,736	63,883	64,852	61,010
Total Liabilities	161,187	168,898	163,266	166,167	164,537
Total Equity	115,368	96,347	100,615	104,079	109,005
Total Equity & Liabilities	276,555	265,245	263,882	270,246	273,541

* For full definitions of iQmethodSM measures, see page 7.

Company Description

Legacy SBC acquired legacy AT&T Corp. in November 2005 to form the new AT&T Inc., which completed its acquisition of BellSouth at YE06. AT&T now operates over 57 million telephone lines, owns 100% of wireless operator AT&T Mobility LLC and is the nation's largest telecommunications company.

Investment Thesis

AT&T is fundamentally sound with a stable subscription-based business model. However, potential for negative estimate revisions and valuation at the high end of the historic range support our Neutral rating. M&A and wireless margin expansion have driven premium earnings growth and fueled the story, but they are running out of steam at a critical juncture. We expect rising wireless substitution to drive accelerating line loss on the wireline side while wireless margins will remain under pressure.

Stock Data

Average Daily Volume 27,299,352

Quarterly Earnings Estimates

	2008	2009
Q1	0.57A	0.53A
Q2	0.63A	0.54A
Q3	0.55A	0.54A
Q4	0.41A	0.51E

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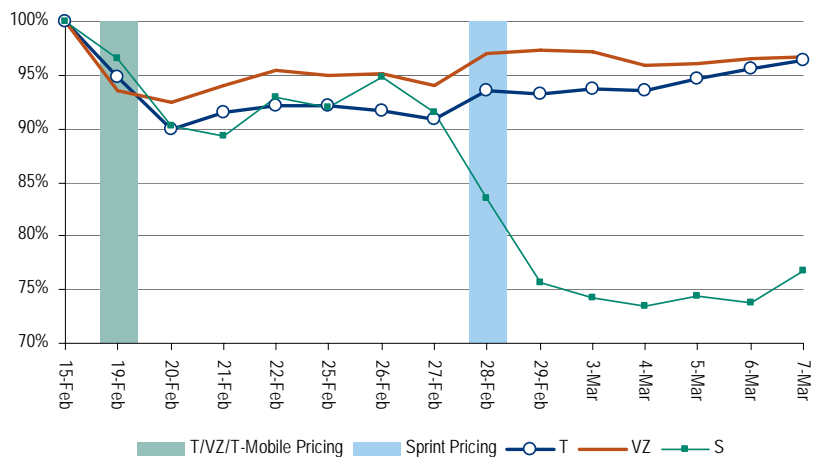
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Verizon's move to lower high end pricing and raise mid-tier pricing must have anticipated AT&T's response given the broadside attack it represented and AT&T's past history of response. The focus now then is on who, beyond Verizon's own customers, was the real target of the move. The answer would appear to be Sprint, which among the laggard national providers has worked the hardest to cultivate a higher end clientele with its Simply Everything plan and which has led the market down with its Any Mobile, Anytime, mid-tier plan. We would not expect a quick reaction from Sprint given its industry-low service margin, recent price moves in the fall, and likely desire to evaluate the 1Q impact of these AT&T and Verizon moves.

Revisiting the last go 'round

AT&T's rapid action recalls its response to Verizon's introduction of high end unlimited plans in February 2008 which occurred within 24 hours of the Verizon announcement. At that time, Verizon's move was, after the fact, considered largely a non-event because it did not impact a meaningful percentage of users and in fact eliminated large, shared, bucket minute plans resulting in price increases for many volume users.

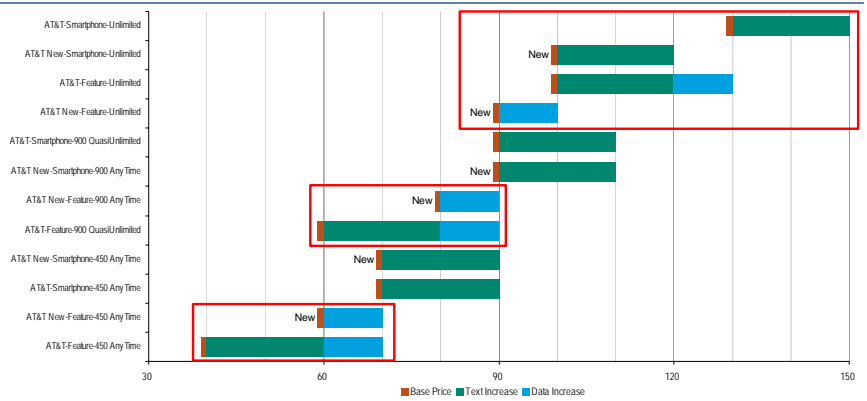
Chart 1: Sprint took the biggest hit in 2008 during the industry's last round of pricing innovation which coincided with year end results



Note: Returns relative S&P500
Source: FactSet

New vs. old plan comparison

Chart 2: AT&T follows Verizon's lead.



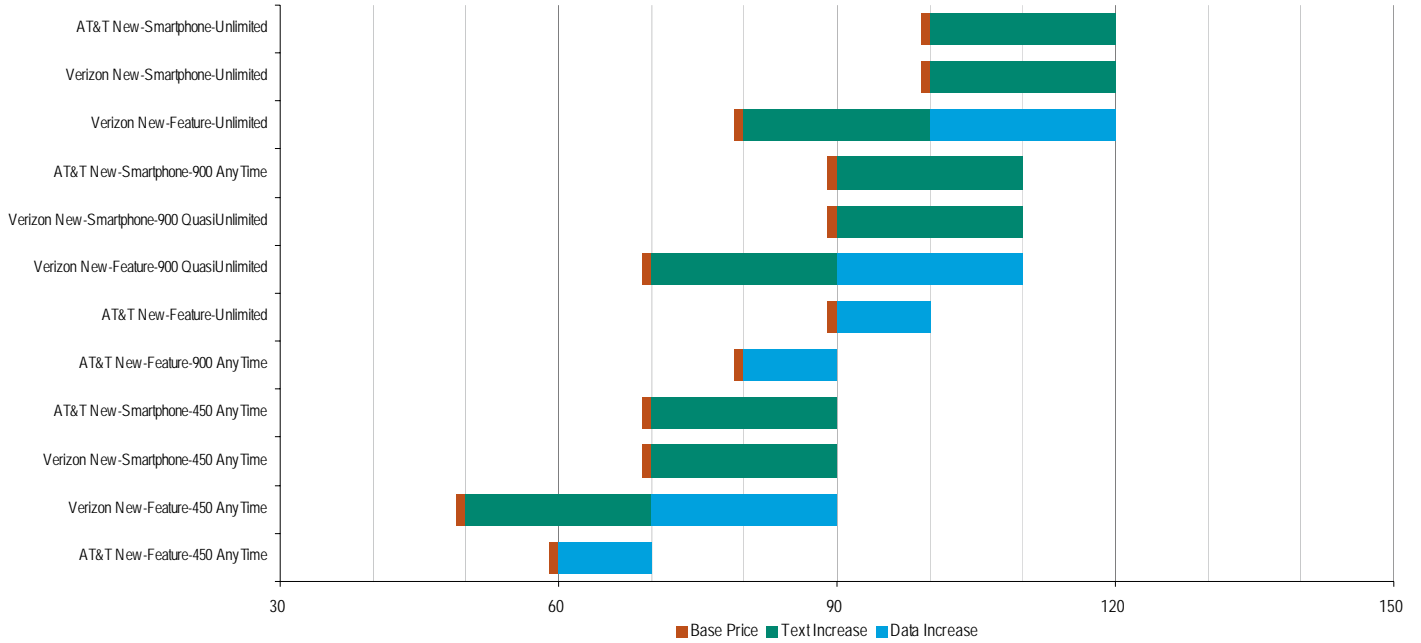
Source: BofA Merrill Lynch Global Research estimates

AT&T's plan change is nearly identical to Verizon's announced change save for a few key differences. AT&T is setting itself up to be \$20 cheaper than VZ for all limited voice + unlimited messaging + data for enhanced tier devices.

- AT&T looks to be lowering prices for all unlimited offers. The unlimited voice component falls by \$30.
- All feature devices are required to take at least a \$20 messaging and/or data plan vs. Verizon's \$9.99 25MB data plan required by Verizon. Smartphone devices are required to take a \$29.99 data plan for both carriers.
- Unlimited all-in prices fall by \$30 for all devices, vs. Verizon's \$20 for enhanced and \$30 for smartphones and basic devices
- Unlimited Data & Text for enhanced devices is \$30 at AT&T vs. \$50 at Verizon.

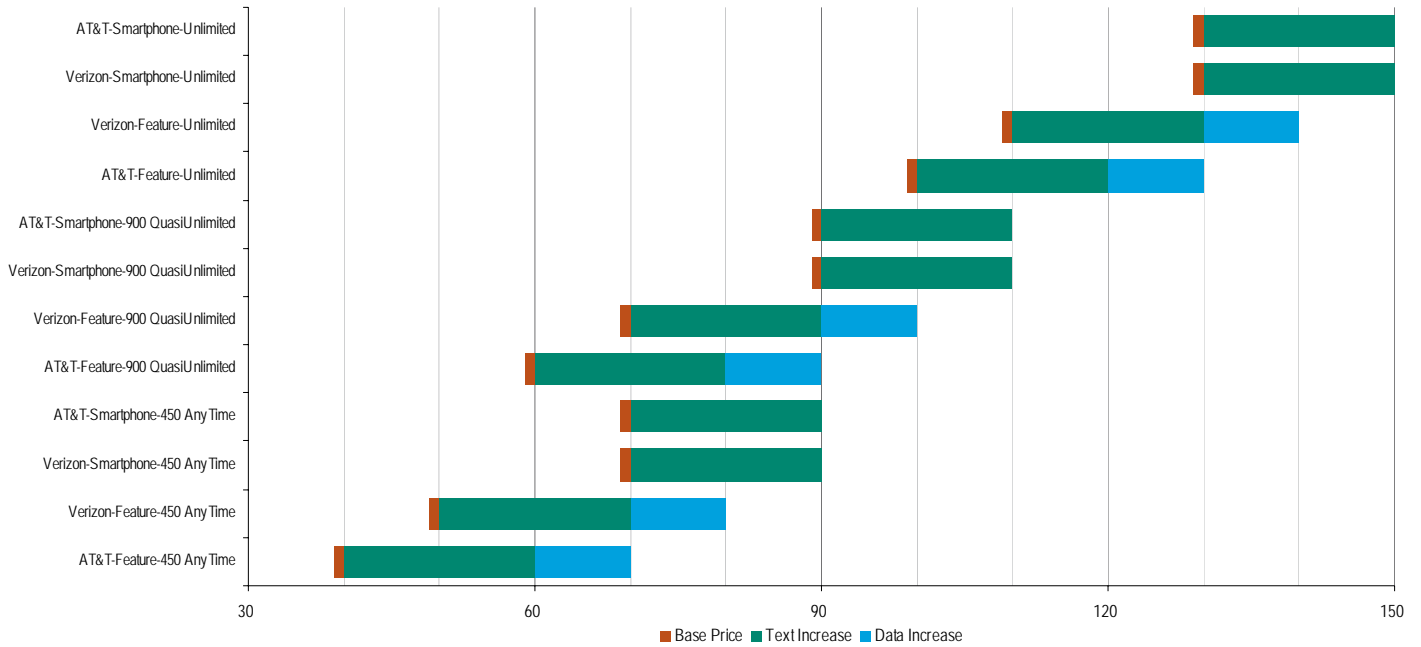
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Chart 3: AT&T and Verizon New Plans – Plans range from \$49.99 to \$119.99



Source: BofA Merrill Lynch Global Research estimates

Chart 4: AT&T and Verizon Old Plans – Plans ranged from \$39.99 to \$149.99



Source: BofA Merrill Lynch Global Research estimates

Price objective basis & risk

AT&T Inc. (T)

Our \$30 12-month price objective is based on DCF and market relative valuation analysis and reflects forward PE and terminal EBITDA multiples of 15x and 4.5x. AT&T has traded at 0.7x to 0.95x the S&P multiple on an historic basis, with a mean of 0.8x. Our price objective assumes that these historic levels hold. For our DCF analysis we assume a cost of equity of 10.9%, a cost of debt of 5.9% and a beta of 1.3x.

The risks to our price objective are: 1) negative estimate revisions to 2009E consensus EPS. 2) greater than expected consumer downsizing of wireless plans, 3) rising handset subsidy-based competition.

Analyst Certification

I, David W. Barden, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US-Telecom Services Coverage Cluster

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	CenturyTel	CTL	CTL US	David W. Barden, CFA
	Cogent	CCOI	CCOI US	Michael J. Funk
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	Equinix, Inc.	EQIX	EQIX US	David W. Barden, CFA
	Leap Wireless International Inc.	LEAP	LEAP US	David W. Barden, CFA
	MetroPCS Communications Inc.	PCS	PCS US	David W. Barden, CFA
	PAETEC	PAET	PAET US	Michael J. Funk
	Qwest Communications International Inc.	Q	Q US	David W. Barden, CFA
	SBA Communications Corporation	SBAC	SBAC US	David W. Barden, CFA
	TW Telecom	TWTC	TWTC US	Michael J. Funk
	Windstream Corporation	WIN	WIN US	David W. Barden, CFA
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	AT&T Inc.	T	T US	David W. Barden, CFA
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	Sprint Nextel Corp.	S	S US	David W. Barden, CFA
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	Cincinnati Bell Inc.	CBB	CBB US	David W. Barden, CFA
	Clearwire-CL A	CLWR	CLWR US	Michael J. Funk
	Dycom Industries Inc.	DY	DY US	Michael J. Funk
	Frontier Communications Corp.	FTR	FTR US	David W. Barden, CFA

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iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

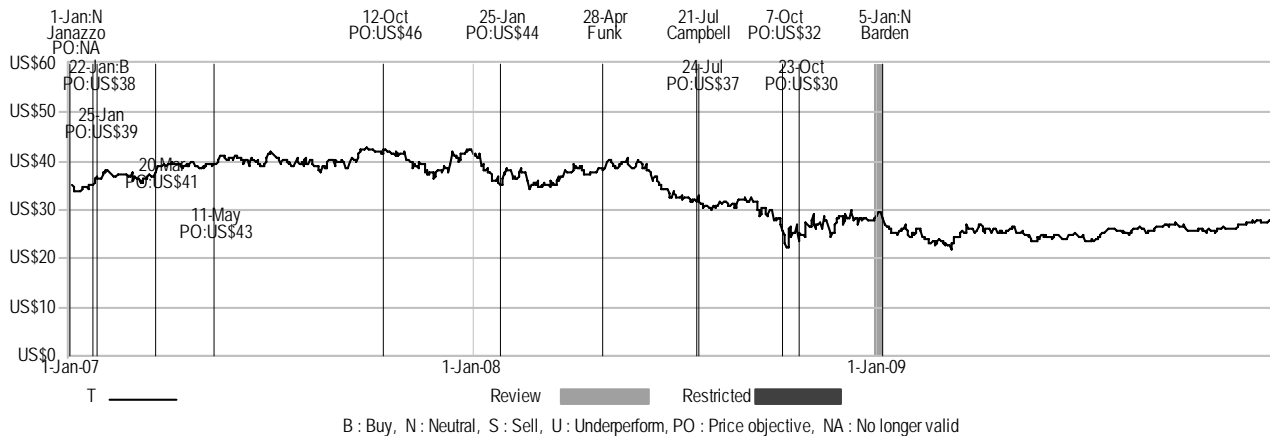
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Important Disclosures

T Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid
 *Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2009 or such later date as indicated.

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Investment Rating Distribution: Telecommunications Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	82	45.81%	Buy	42	61.76%
Neutral	56	31.28%	Neutral	33	75.00%
Sell	41	22.91%	Sell	20	58.82%

Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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