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TO: AT&T SE Local Presidents, District 3 Staff & Secretaries

FROM: Nicholas Hawkins, Assistant to the Vice President

SUBJ: AT&T 2nd Quarter Results – CWA Research Department

Please see the information listed below, which was compiled by CWA's Research Department concerning AT&T's 2nd Quarter results.

AT&T 2Q20 Results

AT&T had a mixed quarter, with $2.8 billion in lost or deferred revenues due to Covid-19, and continued subscriber losses for its postpaid wireless phone and premium TV services. Considering these challenges, the company maintained strong cash flow and profit margins. It also gained 27 million subscribers to HBO Max since its launch, with Max viewers spending 70% more time on the platform than the previous HBO Go offering. Analysts noted that the strong cash flow can cover the dividend and debt payments, but that the wireless business may face stiff competition from the New T-Mobile. Overall, AT&T appears to be using the pandemic to double-down on its cost-cutting initiatives, which continues to impact CWA members through job cuts and store closures. The board of directors may restart the stock buyback program later this year.

Summary of Key Highlights:

- *The company's total employment stands at 243,350; down 1,140 since 1Q20. Adjusting for Time Warner, AT&T has cut 42,268 jobs since December 2017.*
- *As of 2Q20, AT&T has a 2.6x net-debt-to-adjusted-EBITDA ratio (EBITDA is Earnings Before Interest, Tax, Depreciation and Amortization). The company has $153.4 billion in long-term debt at the end of 2Q20, up from $151.3 billion in 4Q19.*
- *The company posted $41 billion in revenues for the quarter; down 8.9% year over year.*
- *Free cash flow was $7.6 billion for the quarter, down 14% from $8.8 billion in 2Q19.*
- *Capital expenditures were $4.5 billion for the quarter, down 18% from $5.5 billion in 2Q19.*

- *Mobility revenues were $17.1 billion, down 0.8% for the quarter. Total wireless subscribers: 171.4 million (up 8.1% year over year). Wireless subscriber growth is being driven overwhelmingly by connected devices, which now represent approximately 41.9% of AT&T's total wireless subscriber base. FirstNet serves >13k first responder agencies and 1.5 million connections.*

- *The Entertainment Group's revenues were down 11.4% year over year mostly due to declines in premium and over-the-top TV subscribers and legacy services.*

- *Both premium TV (DirecTV, U-verse, and AT&T TV) and AT&T TV Now (formerly DIRECTV Now) again saw substantial subscriber losses for the quarter, 886k and 68k, respectively. The company is evolving its video portfolio with the intent of having one distribution platform for entertainment. The company added 225k fiber connections in the quarter, although overall broadband numbers declined by 102k net.*

- *HBO Max (wholesale and retail) had 26.6 million subscribers at June 30, following its launch on May 27. The company plans to launch the AVOD (advertisement based video on demand) version of HBO Max next year.*

COVID-19 Impacts

Workforce

- *"We're moving forward on the 50 work streams … we believe can generate $6 billion in savings over 3 years. […] Our workforce realignment and reduction of labor cost is underway. We restructured some of our benefit plans earlier this year, and we made several moves to streamline operations."*

- *"Some of our least productive stores won't reopen. Other locations will shift to independent distributors, and we're enhancing our online and omnichannel capabilities …"*

- *"Our shift to software-based entertainment with AT&T TV is validating our assumptions on customer self-install. We expect this, coupled with the growth of our fiber-based broadband subscribers, will improve service levels and reduce field operating costs."*

- *"We're also giving our call center representatives improved capabilities to streamline and enhance the sales and service function. And we're rationalizing and modernizing our billing and collection systems."*

Financial

- *"In the second quarter of 2020, we recognized approximately $320 million, or $0.03 diluted share, of incremental costs associated with voluntary corporate actions taken primarily to protect and compensate front-line employee and contractors, and WarnerMedia production disruption costs."*

- *Estimated $2.8 billion of lost or deferred revenues impact from COVID mostly due to the absence of theatrical and television releases and lower advertising from delayed sports programming*

- *The COVID impact is most evident in the company's WarnerMedia results; $1.5 billion revenue impact in the quarter.*

- *Too early to call anything related to stock buybacks, the Board will have its annual planning cycle in September.*

CWA-Represented Segment Results

The Communications segment posted revenue declines of 4.7% on a year over year basis. Sub-segment revenue results were as follows: Mobility down 0.8%; Entertainment Group down 11.4%; and Business Wireline down 3.5%. The Communications segment remains the company's largest revenue contributor at ~82% for the quarter.

In total, AT&T has 171.4 million wireless subscribers (up 8.1% since 2Q19). Subscriber growth is being driven overwhelmingly by connected devices – 71.8 million subscribers for the quarter (up 22.9% since 2Q19). Connected devices are now approximately 41.9% of AT&T's total wireless subscriber base (up from 36.8% in 2Q19 and 30.7% in 2Q18). The company invested $1 billion to acquire 5G spectrum in the quarter.

Postpaid subscribers have been gradually declining over the past two years, minus a slight bump upwards in 4Q19. While the number of postpaid subscribers has hovered continuously around the mid-70 million range, postpaid subscribers are now 43.7% of AT&T's total wireless subscriber base (down from 47.6% in 2Q19 and 52.5% in 2Q18).

Prepaid is contributing to overall subscriber growth albeit minimally – 18 million subscribers for the quarter; up 3.3% since 2Q19. Prepaid contribution to AT&T's total wireless subscriber base has dipped slightly to 10.5% for 2Q20, down from 11% in 2Q19 and 2Q18.

<u>Relevant Sub-Segment Metrics</u>

Mobility (~41.9% revenue contributor)

- *171.4 million total wireless subscribers*

- *151k postpaid phone net losses for the quarter; 135k prepaid phone net adds for the quarter*

- *Postpaid phone churn 0.84% for the quarter, slightly lower than 2Q19 churn of 0.86*

- *Service revenues down 1.1% year-over-year; equipment revenues up 0.3% year-over-year*

- *EBITDA $7.8 billion, up 0.6% year-over-year*

- *Postpaid ARPU trending slightly down, down 0.6% year-over-year*

- *1.5 million FirstNet connections; >13k agencies subscribed*

<u>Entertainment Group (~24.6% revenue contributor)</u>

- *17.7 million Premium TV connections (DirecTV, U-verse, and AT&T TV); down 18% since 2Q19. 886k net losses for the quarter. AT&T's premium TV connections have been steadily declining over the past eight quarters; down nearly 6 million subscribers or 25.2% since 2Q18. On a positive note, premium TV ARPU is up $7.49 (6.4%) from 2Q19 and up $12.79 (11.4%) from 2Q18. AT&T TV saw gains in its first full quarter, which*

helped offset premium video losses. AT&T TV had about a 90% attach rate with AT&T's broadband services.

- *720k AT&T TV Now (formerly DirecTV Now) connections; down 46.3% since 2Q19. 68k net losses for the quarter. AT&T's over-the-top (streaming) product has seen successive subscriber loss over the past seven quarters; down ~1.1 million subscribers or 61.2% since the platform's peak in 3Q18 of ~1.9 million subscribers.*

- *13.9 million Total IP broadband connections (fiber and non-fiber); down 3.3% since 2Q19.*

    - *~31% of IP broadband connections are fiber broadband connections (4.3 million; up 27.9% since 2Q19 and 15.4% since 2Q18). 225k fiber broadband net additions for the quarter.*

    - *~66% of IP broadband connections are non-fiber broadband connections (9.2 million; down 12.4% since 2Q19). 304k net losses for the quarter.*

    - *IP broadband ARPU has steadily increased over the past eight quarters; up $3.29 (6.8%) since 2Q18.*

- *4.1 million U-verse Consumer VoIP connections; down 14.6% since 2Q19 and down 24% since 2Q18.*

Business Wireline (~15.6% revenue contributor)

- *$6.4 billion in revenues, down 3.5% year over year with declines in legacy products partially offset by growth in strategic and managed services.*

- *EBITDA $2.6 billion; 40.7% EBITDA margin (up2.3% year-over-year)*

Workforce Impacts

The company's total employment stands at 243,350; down 1,140 since 1Q20. Adjusting for Time Warner, AT&T has cut 42,268 jobs since December 2017.

Quarterly Change in Total Employment at AT&T				
	AT&T Employment[1]	*AT&T Employment Growth from 2018 Acquisitions [2]*	*AT&T Employment (Excluding Acquisitions)*	*Quarterly Change in AT&T Employment (Excluding Acquisitions)*
12/31/2017	*254,000*		*254,000*	
3/31/2018	*249,240*		*249,240*	*-4,760*
6/30/2018	*273,210*	*30,208*	*243,002*	*-6,238*
9/30/2018	*269,280*	*1,410*	*237,662*	*-5,340*
12/31/2018	*268,220*		*236,602*	*-1,060*
3/31/2019	*262,290*		*230,672*	*-5,930*
6/30/2019	*257,790*		*226,172*	*-4,500*
9/30/2019	*251,840*			*-5,950*
12/31/2019	*247,800*			*-4,040*

3/31/2020	*244,490*			*-3,310*
6/30/2020	*243,350*			*-1,140*
				-42,268
[1] AT&T quarterly reports				
[2] AT&T Proxy Statement (March 11, 2019)				

Additional Segment Results

The WarnerMedia Segment posted revenue declines of 22.9% on a year over year basis. Sub-segment revenue results were as follows: Turner down 12.1%; HBO down 5.2%; and Warner Bros down 3.9%.

Total Domestic HBO Subscribers: 36.3 million; HBO Max (wholesale and retail): 26.6 million. The majority of AT&T's HBO subscribers (65%) are HBO Max wholesale subscribers. The company invested ~$400 million in HBO Max, which is in line with its full year estimate of $2 billion. The average number of weekly hours spent viewing HBO Max is 70% more than on HBO Now.

The Latin America Segment posted revenue declines of 29.9% on a year over year basis. Sub-segment revenue results were as follows: Vrio down 27.1%; and Mexico up 33.8%. Subscriber connections are as follows: 10.7 million Vrio video subscribers, down 2.6 million for the quarter; 18 million Mexico wireless subscribers, down 1.1 million for the quarter.
The Xandr Segment (advertising platform) posted a revenue decrease of 25.4% on a year over year basis.

Relevant AT&T Executive Commentary

Re: DirecTV

"So when I talk about software-based entertainment, I think about the fact that we want a platform with a lot of customers on it that is capable of either delivering general entertainment content under an SVOD construct or whatever is that appropriate mix of live linear moving forward. And I think that's probably the optimal way to meet customer needs as we go forward. Do I think that satellite is necessary to respond in that area? I mean, you can go back and look at comments I made, I think, very early on and post transaction of DIRECTV that we didn't necessarily make that move because we love satellite as a technology to deliver premium entertainment-based video content. We like the customer base. It was an opportunity to move that customer base into the right technology platforms moving forward, and that's clearly where we're investing and what we're doing right now, which is building those software platforms that can deliver either live or on-demand entertainment-based content and have that relationship with the customer, use the data and the analytics we pull from that and, hopefully, bridge off other services that those platforms can ultimately deliver. And I don't necessarily view satellite technology as the place that's necessary to make that happen." – John Stankey, CEO

Re: 5G Replacing Wireline

"I personally do not believe that 5G is a replacement in the near term for suburban, residential, single-family living units. […] I don't believe in the near term that 5G is the right fixed line replacement strategy in what I would call a typical single-family home infrastructure." – John Stankey, CEO

Re: Fiber Buildout
"I have an appetite to get back to building footprint on fiber. […] I have an appetite to build fiber that serves a combination of our needs in the consumer space, what we need to do to deploy 5G and what can help our business segment."

Analyst Commentary
Analysts at Bank of America (BoA) and New Street Research (NSR) were split on AT&T. David Barden at BoA had a more upbeat outlook stating that AT&T's wireless business, which is nearly 50% of the company's EBITDA, offers protection. The company's significant cash flow will allow it to cover the dividend and address its debt, which has been refinanced at lower rates and maturities pushed out. Barden is expecting less severe headwinds for WarnerMedia as sports return, the election nears, and the economy slowly begins to reopen.

Jonathan Chaplin at NSR painted a much more challenging picture. Chaplin noted that AT&T's deployment of 60MHz of new spectrum was expected to drive lower churn and higher net adds, which was not materializing. He also suggested that this may be the "easiest quarter that AT&T will see for a long while" because T-Mobile is focused on merger responsibilities. T-Mobile's strategy of aggressive promotions may impact AT&T postpaid numbers negatively going forward. Chaplin also noted that AT&T is no longer calling for stabilization in DirecTV subscribers. Stankey acknowledged that they won't need a satellite offering forever, but that the DirecTV subscriber base is valuable as potential converts to a software-based distribution platform, which according to NSR makes a sale of DTV unlikely.

While this report contains information that is disheartening, it does give us a realistic look into the direction that AT&T's executives plan to take the company. I encourage you to share it with your membership, as it is informative. Should you have any questions or concerns regarding this report, please feel free to contact me at the District 3 Office.

cc: Richard Honeycutt, Vice President, District 3
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