AT&T, Inc. (T)

Front-End Debt Reduction Takes Advantage of Lower Yields

CORE

We view AT&T's LME as opportunistic because it took advantage of low all-in yields to extend maturities. while lowering the average coupon payment on its bonds. AT&T's sensitivity to interest expense lowers the probability of issuance at the 30y part of the curve unless all-in yields decline materially.

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UPDATE This publication is an update to 'AT&T, Inc. (T): Deleveraging Front End, Leveraging Opportunity', originally published on 14 Feb 2019 at 06:15 EST. We are updating this note to reflect AT&T's release of the final prospectus post-publication of the earlier version of this note, whereby AT&T enhanced its front-end debt reduction plans by $1bn, to a total of ~$7bn. This note also accounts for the below-par issuance price for the new long-end bonds.

We are updating this note to reflect AT&T's plans to use an incremental $1bn of balance sheet cash (total $2bn in balance sheet cash to be used) towards repaying the December 2020 term loan (~$3bn outstanding). As a result of this increase, AT&T will be reducing its front-end debt by ~$7bn, up from $6bn from yesterday. We are also updating the note to reflect the below-par issuance prices for the new notes.

Investment Summary

We consider AT&T's ongoing liability management to be opportunistic, as the company took advantage of low all-in yields to extend maturities while lowering the average effective interest expense on $4bn of bonds by 25bp (adjusted for below-par bonds - 2039s issued at $95.291 and 2029s at $99.508). The company has updated its targeted use of balance sheet cash to $2bn (from $1bn) for a cumulative front-end debt reduction of about $7bn (compared to initial ~$6bn announced yesterday). This exercise would reduce gross debt by ~$1.72bn (net of fees and original issue discount of $133mn), which is a positive, but obviously more needs to be done, which we expect the company to do. The incremental $1bn in gross debt reduction will come through the pay-down of the TLA due in December 2020, which the company expects to redeem fully . As a note, the bonds being taken out as part of this exercise have the highest coupons in the 2020-21 maturity bucket. AT&T's interest expense sensitivity, as reflected in this exercise, raises the question of whether such a liability management exercise will be repeated unless market yields on existing bonds fall further. That said, we continue to expect the company to

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use spare capital to pay down debt, which we think will be focused on all the term loans and the 2019 bonds, followed by the highest-coupon bonds through 2021.

Relative Value: With AT&T 30y now trading about 55bp back of Verizon and limited likelihood of more new debt coming at that part of the curve (because of higher interest expense), we think that AT&T long bonds are becoming more attractive. However, AT&T has the largest industrial corporate debt structure, which has not been lost on investors. Given that most investors already own AT&T bonds, there is a lack of significant incremental demand for the company's bonds. We think that the company itself would have to become an incremental buyer in order for the bonds to outperform significantly from current levels. We remain Market Weight rated on AT&T and Time Warner bonds.

Issuance Details

AT&T issued $5bn in new debt, including $3bn at the 10y and $2bn at the 20y level. These bonds were issued at spreads of 170bp and 220bp, respectively, which implies a new issue discount of about 5-10bp. Both the bonds were issued below par, with the 2039s issued at $95.291 and 2029s at $99.508. The issuance was skewed to the 10y part of the curve because, in our view, the company was careful to keep the interest cost associated with the new issuance below that associated with the bonds being redeemed. The weighted average yield on the $5bn in new issuance (10y and 20y) is 25bp below the average for the six bonds being redeemed.

Redemption Details

AT&T plans to use the proceeds from this issuance, plus $2bn in balance sheet debt, to redeem or repay $4.1bn in front-end maturities and some of the outstanding term loans (~$2.6bn). While the company has not provided details as to how it plans to redeem or repay these bonds, we expect them to be made whole, as the bonds trade very close to make-whole spreads. We also expect the company to receive a marginal tax benefit from the redemption.

FIGURE 1. **Bonds to be redeemed**

Ticker	Coupon (%)	Maturity	Amt Out ($mn)	Currency	Current spread (bp)	Make whole spread (bp)
T	5.200	3/15/2020	890	USD	47	25
DTV	5.000	3/1/2021	40	USD	120	25
T	5.000	3/1/2021	1,120	USD	63	25
TWX	4.750	3/29/2021	1,000	USD	68	25
TWX	4.700	1/15/2021	1,000	USD	68	30
DTV	4.600	2/15/2021	38	USD	108	30
Totals			**4,088**			

Source: Company reports, Bloomberg, Barclays Research

Key Takeaways

The exercise reduces interest expense: One of the main objectives of the exercise seems to be to take advantage of all-in yields that are close to their 12-month lows, aided significantly by the decline in Treasury yields, as well as recent spread compression. This liability management exercise reduces the average interest expense for the company, as the long bonds being issued have lower average coupons than the bonds being redeemed.

FIGURE 2. **Secondary Trading Levels - AT&T 10y and 20y Yields**

Source:Barclays Live - Chart

FIGURE 3. **Weighted Average Coupon Lower for New Bonds Than for Bonds Being Redeemed ($ million)**

Bonds to be redeemed

Ticker	Coupon (%)	Maturity	Amt Out ($mn)	Currency	Annual interest
T	5.200	3/15/2020	890	USD	46
DTV	5.000	3/1/2021	40	USD	2
T	5.000	3/1/2021	1,120	USD	56
TWX	4.750	3/29/2021	1,000	USD	48
TWX	4.700	1/15/2021	1,000	USD	47
DTV	4.600	2/15/2021	38	USD	2
Totals			**4,088**		**201**
Weighted Avg. Coupon	**4.905%**				

Bonds to be issued

Ticker	Coupon (%)	Maturity	Amt Out ($mn)	Currency	Annual interest
T	4.350	3/1/2029	3,000	USD	131
T	4.850	3/1/2039	2,000	USD	97
Totals			**5,000**		**228**
Weighted Avg. Coupon	**4.550%**				
Difference in avg. coupon	**(35.5bps)**				

Note: Above calculation refers to The difference in average effective interest rate on in bonds is 25bps, which reflects the below par issuance of the new bonds.
Source: Bloomberg, Barclays Research

According to our calculations, AT&T will be paying a weighted average coupon of approximately 4.55% on the new issues, which is 35.5bp lower than that of the debt being redeemed (calculations above). However, this difference falls to 25bp once we account for the $133mn in original issue discount. We believe the reason behind issuing below par bonds is to keep ongoing interest expense low (which benefits the EPS ongoing basis) even as OID payments would likely be treated as one time losses for non-GAAP accounting purposes.

FIGURE 4. Bonds to Be Redeemed Have Some of the Highest Coupons on AT&T's Front End

Ticker	Coupon (%)	Maturity	Amt Out ($mn)	Currency	To be redeemed
T	7.850	1/15/2022	103	USD	
T	7.850	1/15/2022	83	USD	
T	5.200	3/15/2020	890	USD	Y
DTV	5.000	3/1/2021	40	USD	Y
T	5.000	3/1/2021	1,120	USD	Y
TWX	4.750	3/29/2021	1,000	USD	Y
TWX	4.700	1/15/2021	1,000	USD	Y
DTV	4.600	2/15/2021	38	USD	Y
T	4.600	2/15/2021	683	USD	
T	4.450	5/15/2021	853	USD	
T	4.333	4/26/2019	1,000	USD	
TWX	4.000	1/15/2022	500	USD	
T	3.875	8/15/2021	1,172	USD	
T	3.825	11/25/2020	1,000	CAD	
DTV	3.800	3/15/2022	65	USD	
T	3.800	3/15/2022	1,012	USD	
TWX	3.400	6/15/2022	500	USD	
T	3.200	3/1/2022	1,250	USD	
T	3.000	2/15/2022	1,457	USD	
T	3.000	6/30/2022	1,962	USD	
T	2.800	2/17/2021	1,695	USD	
T	2.650	12/17/2021	1,000	EUR	
T	2.625	12/1/2022	1,119	USD	
T	2.450	6/30/2020	2,750	USD	
T	2.300	3/11/2019	1,850	USD	
TWX	2.100	6/1/2019	650	USD	
T	1.875	12/4/2020	1,000	EUR	
T	1.450	6/1/2022	1,500	EUR	
T	0.500	12/4/2019	450	CHF	
T	ZERO	11/27/2022	593	USD	
T	STEP CPN	1/2/2020	9	USD	
T	FRN	3/11/2019	400	USD	
T	FRN	6/4/2019	1,500	EUR	
T	FRN	1/15/2020	800	USD	
T	FRN	6/30/2020	687	USD	
T	FRN	8/3/2020	2,250	EUR	
T	FRN	6/1/2021	1,500	USD	
T	FRN	7/15/2021	1,500	USD	

Note: Includes AT&T bonds with 3y and below maturity, sorted by coupon.
Source: Bloomberg, Barclays Research

Transaction will be largely leverage neutral: Total debt will decline marginally given that the company noted it will be using $2bn cash on hand, in addition to the proceeds from issuance, to repay the front-end bonds. However, net debt will increase slightly because of the premium paid toward debt redemption. We expect the premium to be paid on the bonds to be about

$150mn, which at an approximately 30% rate implies a $45mn tax shield and a -$0.02 effect on 12-month GAAP EPS.

FIGURE 5. **Effect on Leverage to Be Minimal**

	12/31/2019	Adjustment*	Pro-forma
Cash	$5,204	($2,000)	$3,204
Total Debt	176,505	(1,717)	$174,788
Net Debt	171,301	150	171,584
PF Adj. EBITDA (Company reported)	60,578		60,578
Total Debt/EBITDA	2.91x		2.89x
Net Debt/EBITDA	2.83x		2.83x

Note: Assumes that reduction in gross debt is $1.72bn. Also assumes $2bn in cash and incremental proceeds from the bond issuance is used to pay for term loan paydown. * Cash decrease due to $2bn cash on hand used to fund redemptions; gross debt decreases because more debt is being redeemed than being issued; net debt increases because of assumed cash being used to pay for debt redemptions
Source: Barclays Research

FIGURE 6. **Company to Reduce Gross Debt by About ~$1.72bn, Total Front End Debt by ~$6.72bn**

Bonds to be redeemed

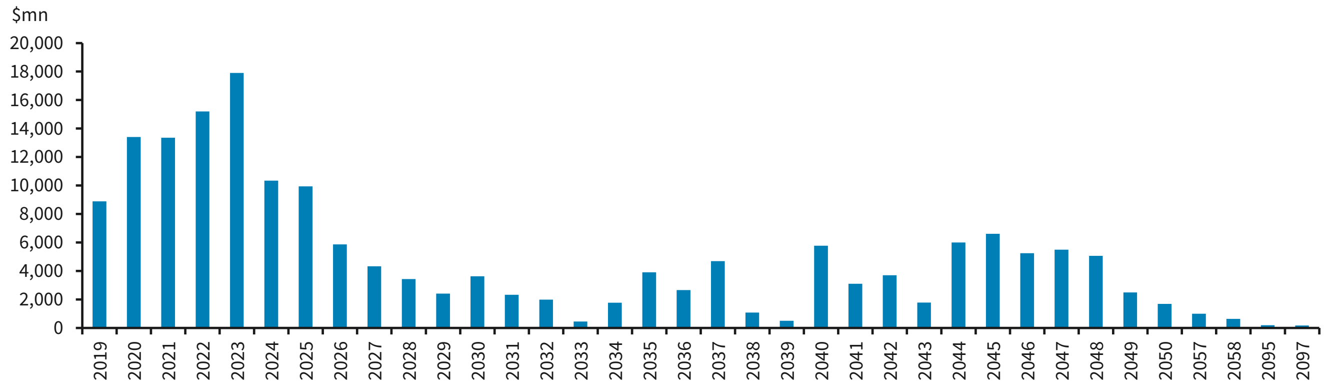
Ticker	Coupon (%)	Maturity	Amt Out ($mn)	Currency	Current spread (bp)	Make whole spread (bp)	Make whole price	Redemption Consideration
T	5.200	3/15/2020	890	USD	47	25	$102.6	913
DTV	5.000	3/1/2021	40	USD	120	25	$104.4	42
T	5.000	3/1/2021	1,120	USD	65	25	$104.4	1,169
TWX	4.750	3/29/2021	1,000	USD	70	25	$104.0	1,040
TWX	4.700	1/15/2021	1,000	USD	71	30	$103.5	1,035
DTV	4.600	2/15/2021	38	USD	109	30	$103.0	39
Totals			**4,088**					**4,237**
Premium vs. par								**150**
Total cash used for debt redemption (including net issuance proceeds and $2bn cash on hand)(1)								**6,867**
Cash left for TL paydown after bond redemptions								**2,630**
Total debt principal to be paid down (bonds + TLs)								**6,717**
Total debt issued								**5,000**
Reduction in gross debt from issuances and redemptions (debt principal to be repaid less debt issued)								**1,717**

Note: Assumes $5bn in issuance, $3bn at 10y and $2bn at 20y with both notes being issued below par ($99.508 and $95.291, respectively). Also assumes $2bn in cash on hand is used to pay premium on redemptions and for term loan pay down.
Source: Bloomberg, Barclays Research

Limited effect on structural subordination: We believe the ongoing liability management exercise will do little to address the structural subordination issue. We estimate around a 1% reduction ($2bn) in structurally senior debt, which is certainly useful but likely not sufficient to fully address the subordination created by the TWX acquisition. With this exercise, AT&T will be reducing about $2.1bn in structurally senior debt and about $4.6bn in old parentco debt and issuing $5bn in new parentco debt.

Issuance will extend maturities: The deal will help AT&T extend its maturity profile, reducing front-end debt by ~$7bn with the issuance of new 10y and 20y notes. We view the maturity extension as a positive given that the large amount of debt coming due in the next five years has been a point of concern for investors.

FIGURE 7. Current AT&T Debt Maturity Profile



Source: Bloomberg, Barclays Research

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Bloomberg Barclays U.S. Credit Index		
	Old	**New**
U.S. HG Media Entertainment	Underweight	Underweight
TIME WARNER INC	Market Weight	Market Weight
U.S. HG Wirelines	Overweight	Overweight
AT&T INC	Market Weight	Market Weight

Source: Barclays Research

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Primary Issuers/Bonds
AT&T INC, Market Weight, A/CD/CE/D/E/J/K/L/M/N

Valuation Methodology: Market Weight owing to a combination of wide spreads and the large amount of debt raised in order to fund the TWX transaction.

Risks that May Impede Achievement of the Rating: Ratings, leverage, and issuance risks.

Representative Bond: T 4 3/4 05/15/46 (USD 92.89, 13-Feb-2019)

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Valuation Methodology: Market Weight given our belief that there is limited potential upside to the bonds from current levels as the probability of TWX being separated from AT&T is very low.

Risks that May Impede Achievement of the Rating: Separation of TWX assets, removal of guarantees, industry declines.

Representative Bond: TWX 4.85 07/15/45 (USD 95.93, 13-Feb-2019)

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Market Weight (MW):
The analyst expects the six-month excess return of the country's index eligible bonds to be in line with the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

Underweight (UW):
The analyst expects the six-month excess return of the country's index eligible bonds to be less than the six-month excess return of the Bloomberg Barclays EM USD Sovereign Index.

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