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September 9, 2019

The Board of Directors
AT&T Inc.
208 South Akard St.
Dallas, TX 75202
Attn: Chairman Randall Stephenson
Attn: Lead Director Matthew Rose

Dear Members of the Board:

We are writing to you on behalf of Elliott Associates, L.P. and Elliott International, L.P. (together, "Elliott" or "we"). Elliott owns $3.2 billion of the common stock and economic equivalents of AT&T Inc. (the "Company" or "AT&T"). The large scale of our investment reflects our deep conviction in the extraordinary value opportunity realizable at AT&T today.

AT&T is unquestionably one of the world's most important companies and one of America's proudest technological stories. Nearly 150 years after its founding, AT&T remains a vital steward of global infrastructure, serving more than 370 million direct-to-consumer relationships and employing more than 250,000 people across virtually every country in the world. There is a great deal at stake in ensuring that AT&T realizes its potential – for shareholders, for consumers, for employees, and even for the U.S. as a global telecom leader.

It is through this lens that Elliott approaches its investment in AT&T. Though it is outside the scope of this letter to detail AT&T's rich and pioneering history, we want to make clear that Elliott has tremendous respect for the Company's legacy, as well as for the hard work, ingenuity and passion of its dedicated employees, who work tirelessly to ensure our world remains connected.

The purpose of today's letter is to share our thoughts on how AT&T can improve its business and realize a historic increase in value for its shareholders. Elliott believes that through readily achievable initiatives – increased strategic focus, improved operational efficiency, a formal capital allocation framework, and enhanced leadership and oversight – AT&T can achieve **$60+ per share of value by the end of 2021**. This represents 65%+ upside to today's share price – a rare opportunity for any company, let alone one of the world's largest.

Our letter today is organized as follows:

- **Long-Term Underperformance**: AT&T's shareholder returns have been disappointing over a prolonged period.
- **How We Got Here**: A combination of strategic and operational setbacks has eroded AT&T's business focus and shareholder value.

- **The AT&T Opportunity**: Despite the setbacks, AT&T still possesses a world-class collection of leading assets, priced today at historically discounted levels.
- **The Activating AT&T Plan**: AT&T can unlock significant value by focusing its asset portfolio, improving operational performance, instituting clear capital priorities, and enhancing leadership and oversight.
- **Upside of a Unique Magnitude**: These steps will create value that is substantial and achievable today.

Elliott looks forward to working collaboratively with the AT&T team to act on this opportunity and realize the Company's full potential.

**Elliott's Investment in AT&T**

Elliott is an investment firm founded in 1977 that today manages approximately $38 billion of capital for both institutional and individual investors. We are a multi-strategy firm, and investing in the Technology, Media and Telecom (TMT) sector is one of our most successful efforts.

Elliott's approach to its investments is distinguished by our extensive due diligence, and our efforts on AT&T have followed this same approach. We enlisted former executives, industry experts, investment bankers, lawyers, accountants and consultants in an exhaustive diligence effort spanning AT&T's numerous businesses. Selected examples of our efforts include:

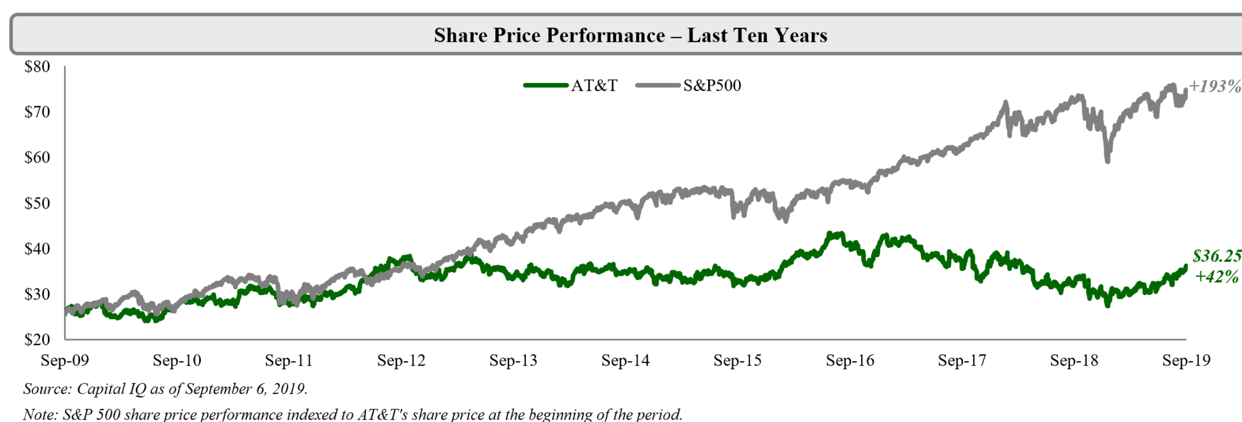
- A leading strategy consulting firm surveyed the wireless, pay TV, and broadband preferences of more than 35,000 consumers to understand evolving consumer trends;
- A premier cost and optimization consulting firm analyzed AT&T to assess the opportunity for operational improvements and quantified the potential cost savings;
- A leading network advisory practice evaluated the evolving wireless and wireline dynamics, including AT&T's potential path to 5G leadership;
- We engaged in conversations with more than 200 former AT&T and industry executives to accurately evaluate the current situation through the lens of AT&T and its peers; and
- We surveyed more than 60 of the largest TMT investors to gauge shareholder sentiment.

We believe that this time- and resource-intensive exercise has given us a thorough understanding of the Company's existing strengths and opportunities for improvement. It is important to emphasize that the observations made below regarding the Company's recent strategic and operational decisions are drawn directly from this wide-ranging diligence and reflect broadly shared views on AT&T's recent history and required future direction. We have carefully tested the views of others against our own, and we are convinced that the resulting recommendations will both maximize shareholder value and best position AT&T for long-term success.

## Long-Term Underperformance

What has attracted our attention, as well as the attention of other shareholders – from large institutions to individual AT&T employees – has been the prolonged and substantial underperformance of AT&T as an investment relative to its potential. Over the past ten years, for example, AT&T – a "bellwether" in all senses of the word – has not only failed to keep pace with the broader market, but has actually *underperformed by over 150 percentage points*:

**Share Price Performance – Last Ten Years**




*Source: Capital IQ as of September 6, 2019.*

*Note: S&P 500 share price performance indexed to AT&T's share price at the beginning of the period.*

This underperformance also holds for AT&T's Total Shareholder Return ("TSR", stock price plus dividends). Over the past decade, AT&T's TSR has lagged the S&P 500's TSR by well over 100 percentage points. In fact, AT&T's underperformance has been so severe and disappointing that it was dropped from the Dow Jones Industrial Average in 2015, an index that has included AT&T and its predecessors since 1939.

Unfortunately for shareholders and the millions of current and former employees who own shares in AT&T as part of their remuneration or pension, this underperformance has been both profound and persistent. AT&T's TSR has underperformed across all relevant benchmarks and timeframes for more than 10 years, with the exception of a small catch-up over the last year following the Company's 27% share price decline in 2018 and coinciding with Elliott's large purchases of stock.

**Relative Total Shareholder Return**

| | Period Ending September 6, 2019 | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **AT&T's TSR Relative to:** | **1 Year** | **2 Years** | **3 Years** | **4 Years** | **5 Years** | **6 Years** | **7 Years** | **8 Years** | **9 Years** | **10 Years** | **Current Mgmt.[2]** |
| **1. Proxy Peer Group[1]** | 13% | (13%) | (45%) | (43%) | (32%) | (93%) | (111%) | (168%) | (127%) | (107%) | (134%) |
| **2. Verizon** | 6% | (26%) | (23%) | (20%) | (13%) | (17%) | (43%) | (41%) | (82%) | (88%) | (95%) |
| **3. S&P 500** | 14% | (14%) | (41%) | (30%) | (29%) | (53%) | (100%) | (102%) | (110%) | (114%) | (78%) |
| **4. Dow Jones Industrial Avg.** | 14% | (17%) | (51%) | (45%) | (41%) | (57%) | (98%) | (93%) | (106%) | (118%) | (95%) |

*Source: Bloomberg as of September 6, 2019. Assumes dividends are reinvested.*

*(1) Reflects median of GOOG, AMZN, AAPL, BA, CBS, CHTR, CVX, CSCO, CMCSA, XOM, GE, INTC, IBM, MSFT, ORCL, S, TMUS, VZ, VIAB, WMT, DIS.*

*(2) Reflects returns since current CEO appointment on June 4, 2007.*

As you can see, AT&T has been a disappointing investment for its shareholders relative to nearly any benchmark.

## How We Got Here

Below, we briefly summarize the business issues that have led AT&T to its current state, which we categorize into two groups: I) **Strategic Setbacks** and II) **Operational Underperformance**. We welcome the opportunity to share more detailed thoughts on these topics in our conversations with the Board.

### I. A Series of Strategic Setbacks

To fully appreciate the significance of the Company's decisions and to contextualize them appropriately, we think it useful to revisit how AT&T first found success.

Originating in 1984 as the smallest of the Baby Bells, Southwestern Bell (later renamed SBC) quickly embarked on an aggressive yet focused strategy of growth and execution. Under the famed stewardship of Ed Whitacre, SBC radically transformed the country's wireline and wireless industries. Over the decade between 1997 and 2007, SBC acquired Pacific Telesis, Southern New England Telephone, Ameritech, Comcast Cellular, AT&T Wireless, BellSouth and, of course, the AT&T Corporation. In doing so, the now re-named AT&T became the nation's largest telecommunications company.

Whitacre's strategy was successful – the Company had a clear strategic rationale for the assets it acquired and a plan to execute across the business as a whole. The results, too, differed from AT&T's current situation: From 1984 through Whitacre's retirement in June 2007, AT&T shares returned over 2,000%, handily outpacing the results of either the S&P 500 or AT&T's primary competitor, Verizon. On the day Whitacre retired, AT&T's stock price closed at $40.53, a level it remains below today.

In recent periods, however, AT&T has embarked upon a very different sort of M&A strategy. Over a series of deals totaling nearly **$200 billion**, AT&T built a diversified conglomerate by pushing into multiple new markets. In each case, the push was as significant as possible. Beginning the decade as a pure-play telecom company with leading wireless and wireline franchises, AT&T has transformed itself into a sprawling collection of businesses battling well-funded competitors, in new markets, with different regulations, and saddled with the financial repercussions of its choices:

- *T-Mobile:* Possibly the most damaging deal was the one not done. In March of 2011, AT&T attempted to acquire T-Mobile for **$39 billion**. At the time, T-Mobile was a distant fourth-place competitor struggling to keep pace with AT&T and Verizon. Not long after announcement, it became obvious that the government would block the deal, and the parties terminated. Unfortunately for AT&T and the industry, AT&T paid the largest break-up fee of all time and provided T-Mobile with a seven-year roaming deal and the invaluable spectrum it needed to develop from a then-struggling competitor into the thriving force it is today. Over the following years, T-Mobile went on to introduce a number of disruptive initiatives that upended the wireless industry. In addition to the internal and external distractions it caused itself, AT&T's failed takeover capitalized a viable competitor for years to come.

- *DirecTV:* The next large deal AT&T attempted did close, but with damaging results. In 2014, AT&T announced the **$67 billion** acquisition of DirecTV, becoming the largest pay TV operator in the country. Notwithstanding AT&T leadership's assertions that "*Pay TV is a very good, durable business*" when the transaction was announced, the pay TV ecosystem has been under immense pressure since the deal closed. In fact, trends are continuing to erode, with AT&T's premium TV subscribers in rapid decline as the industry, particularly satellite, struggles mightily. Unfortunately, it has become clear that AT&T acquired DirecTV at the absolute peak of the linear TV market.

- *Time Warner:* In 2016, AT&T announced its most significant bet, the **$109 billion** acquisition of Time Warner. Time Warner is a spectacular company, representing a collection of some of the world's premier media assets, and it remains a strong and valuable franchise today. However, despite nearly 600 days passing between signing and closing (and more than a year passing since), AT&T has yet to articulate a clear strategic rationale for why AT&T needs to own Time Warner. While it is too soon to tell whether AT&T can create value with Time Warner, we remain cautious on the benefits of this combination. We think that, after $109 billion and three years, we should be seeing some manifestations of the clear strategic benefits by now. We aren't alone in our cautious outlook – Jeff Bewkes, the CEO who sold Time Warner to AT&T, recently referred to the vertical integration of content and distribution as a "*fairly suspect premise.*"

These three transactions are not the only examples of AT&T's recent questionable M&A – the push into the Mexican wireless market, for example, has also severely underperformed expectations – but they are the largest and most damaging.

As long-time followers of Time Warner, we see a contrast between AT&T's M&A strategy and that of Time Warner under Jeff Bewkes: When Bewkes took over Time Warner as CEO, he inherited a sprawling company with numerous related but non-core assets – AOL, Time Warner Cable, a collection of publishing assets and other smaller businesses. He then spent the following decade *divesting* the non-core assets in order to focus on Time Warner's leading content franchises. This strategy paid off: Time Warner became both a flourishing media enterprise and a strong investment, returning more than double the S&P 500's ~140% return during Bewkes' 10-year tenure.

AT&T has been an outlier in terms of its M&A strategy: Most companies today no longer seek to assemble conglomerates. This approach is more characteristic of a prior era, calling to mind the Conglomerate Boom of the 1960s or the Mike Armstrong years at the "old" AT&T. It also represents a departure from the approach articulated in 2007 by the Company's Chairman and CEO at his first analyst day after being named to that position: *"When there's a temptation to want to launch off into areas that may not be closely tied to our strengths or which are going to distract us from an operational focus, that won't happen."*

We firmly believe that AT&T's M&A strategy has not only contributed directly to its profound share price underperformance, but has also caused distractions that have contributed to the Company's recent operational underperformance.

## II. Operational Underperformance

In his final letter to shareholders in AT&T's 2006 annual report, Whitacre opened by saying *"AT&T is a company with a tradition of delivering on our promises."* During the last decade, however, AT&T has not delivered on its promises, as its radical transformation through M&A has coincided with deteriorating operational performance. As Moffett Nathanson summarized: *"The decline in AT&T's shares over the last few years has been more than just a referendum on strategy. It has also been a direct reflection of a steady decline in AT&T's operating performance."*

*Poor Execution in Wireless*

When AT&T (then-SBC) acquired AT&T Wireless in 2004 through its Cingular Wireless joint venture, it became the nation's largest wireless provider. AT&T had every right – if not a mandate – to execute well and expand its lead. Unfortunately, AT&T consistently fell behind, as competitors delivered on network quality commitments, executed on new technology deployments and innovated with disruptive offerings.

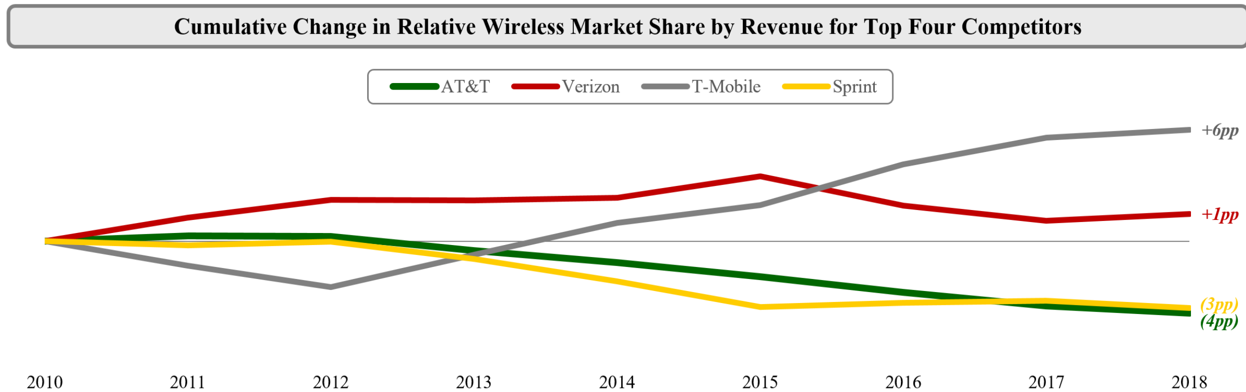
Some examples help illustrate this underperformance:

- *Missed iPhone Potential*: In 2007, AT&T secured exclusive distribution of the iPhone, offering its customers what should have been a unique and game-changing product experience. However, as data usage spiraled, AT&T struggled to scale its infrastructure accordingly and add sufficient capacity, resulting in well-publicized network unreliability and customer-satisfaction issues. What should have been a meaningful brand-enhancer ended up undermining public perception.

- *Sacrificed Network Leadership*: While Verizon moved as quickly as possible to implement 4G LTE, AT&T initially balked, essentially giving Verizon a head start. Verizon took advantage and executed well, quickly being the first to scale its LTE footprint and thereby earning a reputation for superior network quality, as well as $20 billion dollars of additional wireless revenue.

- *Lack of Differential Positioning:* While Verizon was winning mindshare as the network quality leader, T-Mobile was disrupting the industry by eliminating contracts while offering family plans and unlimited packages. Indeed, all competitors were in motion: Verizon took up the premium end of the market, Sprint targeted the low end and T-Mobile was the disruptive innovator. By contrast, AT&T was comparatively static, without clear brand positioning.

The primary consequence of these setbacks and others has been a consistent ceding of market share. In the last decade, T-Mobile has *grown* its share of the "Big 4" wireless revenues by ~600 basis points while AT&T's share has *shrunk* ~400 basis points, making it the worst performer of the group.




*Note: 2018 revenue presented on a historical basis for comparability.*

*Source: Company filings. Relative market share based on combined wireless revenues of AT&T, Verizon, T-Mobile and Sprint.*

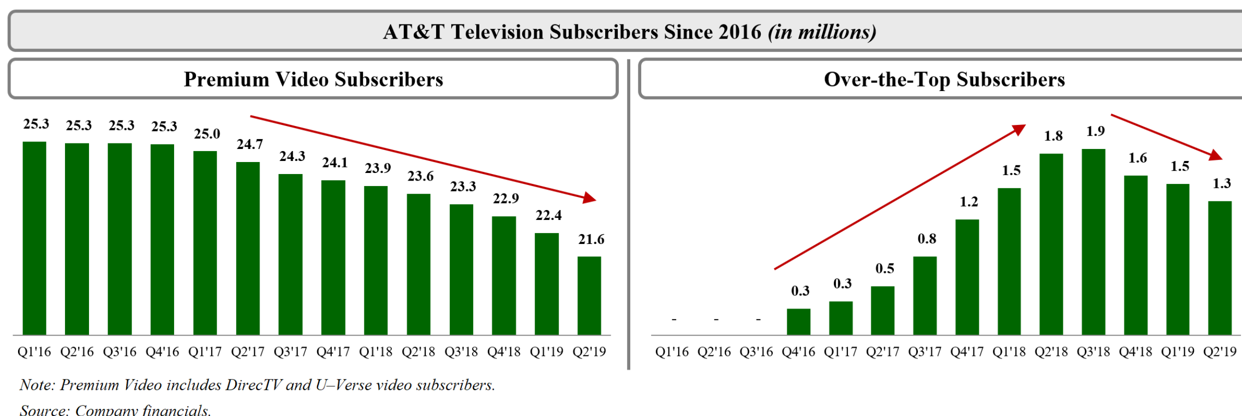
Fortunately, the ongoing 5G transition presents AT&T with **a renewed opportunity to reset the wireless narrative and reclaim market leadership**. AT&T today is in prime position to be the early market leader in 5G given its premier spectrum positioning, early LTE-Advanced work and recent network improvements (driven by the FirstNet build and its one-touch strategy).

We believe AT&T will be able to quickly move forward while its main competitors remain either spectrum-disadvantaged or distracted as they integrate major transactions. However, while AT&T is well positioned, success in 5G will require meaningful investment and improved execution; anything less and AT&T risks missing this opportunity and falling behind again.

*Product Issues*

Beyond the wireless issues detailed above, AT&T has suffered from product issues in other business units that have hampered its ability to remain competitive:

- *DirecTV Over-the-Top (OTT) Issues*: AT&T's OTT offering, DirecTV NOW (renamed AT&T TV Now), has been poorly executed with delays, technical mishaps, weak customer service and usability issues. Despite describing DirecTV NOW as a replacement for DirecTV, the natural-substitution narrative has not played out. While unsustainably low prices and aggressive promotion did initially help the product scale, the benefits turned out to be very short term in nature. As AT&T raised prices to normalized levels, results rapidly deteriorated. After just two years of existence amidst an otherwise-booming OTT market, DirecTV NOW's subscriber count is now declining.



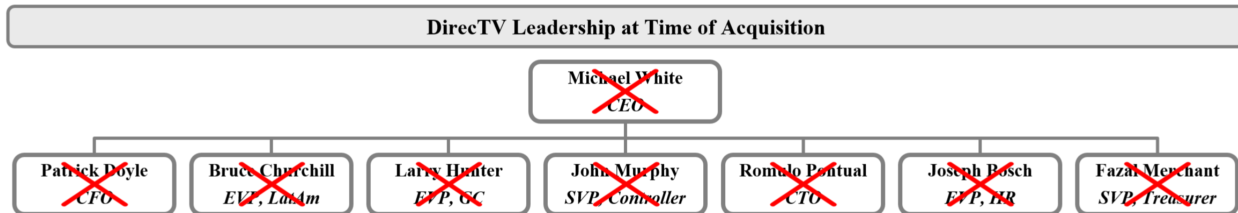

*Note: Premium Video includes DirecTV and U–Verse video subscribers.*
*Source: Company financials.*

- *WarnerMedia Direct-to-Consumer Rollout*: WarnerMedia possesses a leading library of content, and the potential for a direct-to-consumer offering has long been one of the most highly anticipated opportunities. Nonetheless, more than three years after the deal was announced, there is still confusion over strategy and a growing sense that AT&T doesn't have a plan. Last November, AT&T laid out a detailed, three-tiered offering with an emphasis on Warner Brothers (not HBO). Then, just six months later, AT&T scrapped that plan and instead promoted a single new product, HBO Max, with radically different pricing and an already delayed launch. This quick reversal has intensified the skepticism around WarnerMedia, its OTT strategy and the management of the business itself.

Although these two recent examples are top-of-mind, they are not the only ones. Despite more than $4 billion in M&A and an even greater amount committed to ongoing investment, AT&T's wireless operations in Mexico remain unprofitable and below expectations. The Digital Life home security product, highlighted in 2012 as a new and exciting "billion-dollar opportunity," never lived up to expectations. Meanwhile, numerous other initiatives (mobile wallet, internet security, connected car, unified communications, hosting and many more) failed to take off. Even the overall broadband and video deployments merit scrutiny: Misjudging consumer demands for broadband speeds has rendered the original Fiber to the Node (FTTN) deployment suboptimal, while the losses at U-Verse served as a justification for the ill-timed acquisition of DirecTV.

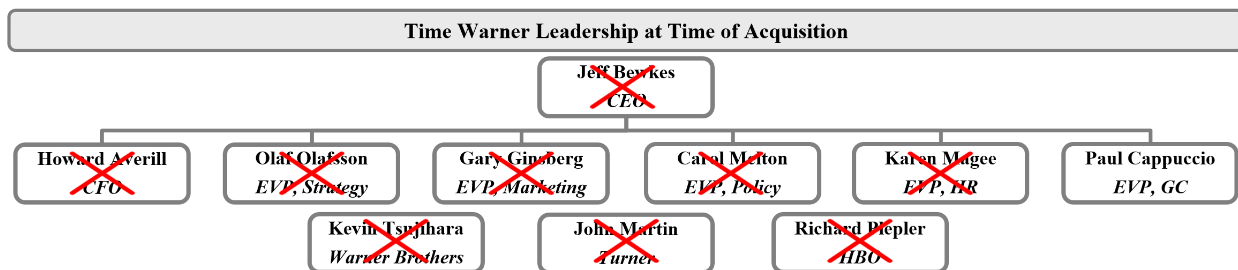
*Retention and Leadership*

Beyond these execution challenges, AT&T has also struggled with human capital issues, including talent retention, recruitment and leadership more broadly. For example, almost immediately after AT&T completed its DirecTV acquisition, the entire DirecTV management team departed. These exits were cause for concern given that DirecTV was a scale asset (~$35 billion sales and 30,000 employees) operating a different technology in a television market where AT&T (through its nascent U-Verse offering) had limited experience. One can't help but wonder whether AT&T's difficulties at DirecTV were compounded by this lack of management continuity and experience.




*Source: Company filings, press releases, news articles.*

WarnerMedia has similarly suffered from alarming executive turnover, a particularly troubling pattern given the very different nature of its businesses compared to those in which AT&T has historically operated. AT&T rightfully praised Time Warner's leadership and cited its creative talent as one of the primary reasons to pursue the transaction: *"The big part of the value of this transaction is Time Warner's outstanding leadership team,"* and *"they are going to be very critical to the success of this business going forward."* Yet just over a year after closing the transaction, almost all of Time Warner's former leadership has left. For a content business now owned by a telecommunications company and under the direct supervision of a lifelong telecom executive, this lack of continuity in leadership presents a real concern for investors and should be a key focus for the Board.



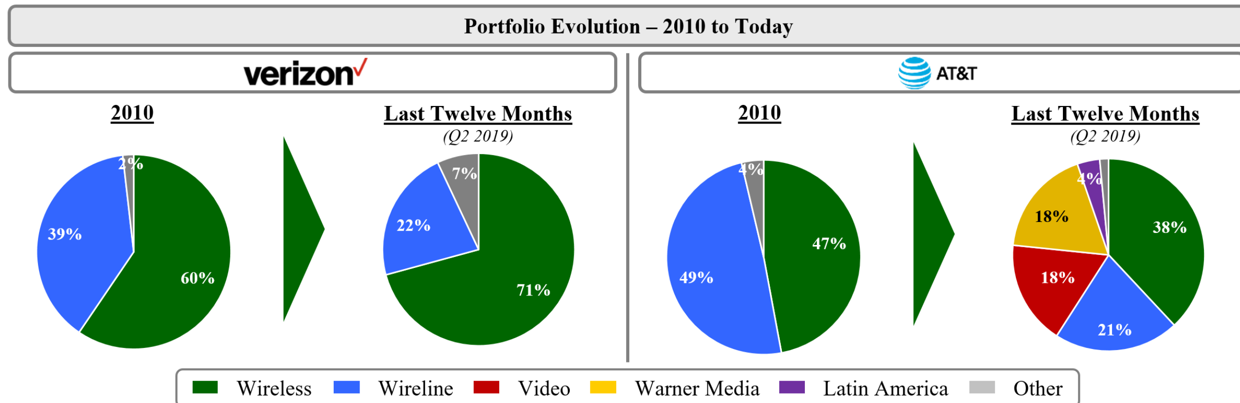

*Source: Company filings, press releases, news articles.*

Moreover, there are growing concerns about the depth of leadership even within AT&T's core businesses. These fears were very recently highlighted by the announced (and surprising) departure of the CEO of AT&T Communications – a collection of wireless, wireline and entertainment assets which account for ~80% of the entire Company's sales. To put this in context, the executive who departed ran a division <u>more than *25% larger than Comcast and roughly twice as large as Disney*</u>. Instead of conducting a thorough search for the most qualified executives available, AT&T decided to wait a week and then announce that the recently installed CEO of WarnerMedia – itself a massive and very different business that clearly requires a full-time manager – would now *also* be responsible for an additional $145 billion of revenue as the President and COO of the entire Company.

Given the critical juncture at which each of AT&T's businesses stands today, improving its approach to recruiting, retention, succession and governance must be a key priority for management and the Board.

**The Result: A Challenged Financial Narrative**

The Strategic Setbacks and Operational Underperformance discussed above have weighed heavily on the financial performance of the Company and on the ability of its executives to manage it. In retrospect, this is unsurprising – not only did AT&T engage in a massive transformation of its asset mix, but it did so with breathtaking speed. In just a matter of years, AT&T bought its way from a pure-play wireless and wireline business to what it today calls a "modern media company." By contrast, its closest peer, <u>Verizon, pursued the opposite path by reducing its wireline footprint and doubling down on the strong wireless market</u>.

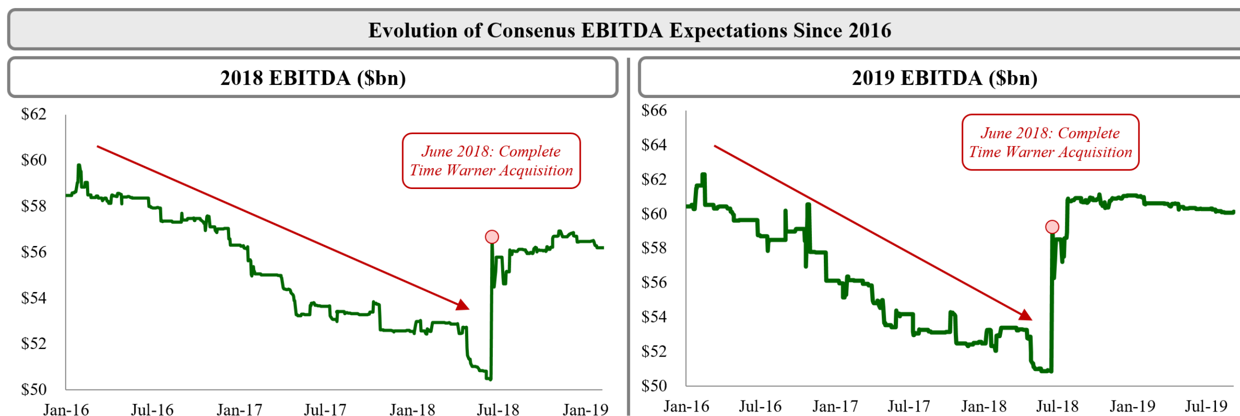



*Note: For AT&T, video reflects video entertainment; wireline includes high-speed internet, legacy voice and data, and other Entertainment Group revenues.*
*Source: Company filings.*

The picture above tells this story and also helps frame why AT&T is such a challenging business to manage and understand – both for its managers and for its shareholders. For its managers, each of the business units is extremely complex in and of itself, competing against large and well-funded competitors in rapidly changing landscapes, some in areas where AT&T has neither history nor expertise. Moreover, it is competing in these arenas on the largest scale possible: Each of these "business units" is either the first- or second-largest player in its industry, and each of AT&T's four primary business lines would be a large-cap company on its own. It makes sense that companies today no longer "diversify" as they did decades ago: Managing this level of change, this quantity of integration and this degree of competition is almost always value-destructive. As Morgan Stanley astutely cautioned at the time of the Time Warner deal:

> *"**Challenging execution:** One of our major concerns with any Telecom M&A deal is when the companies move too far from their core business at a time when many of AT&T's existing businesses are facing secular challenges. The telecom industry has many examples of deals which failed to reach their potential, or destroyed significant value, including investments in content."*

The lack of focus has affected AT&T's performance and its management's ability to live up to expectations – both internally and externally. For example, analyst expectations for AT&T's earnings have declined precipitously and consistently since 2016 – almost in a straight line as the Company's performance has proved disappointing. In fact, as many have observed, both AT&T's actual 2018 EBITDA and analyst expectations for its 2019 EBITDA are now lower than they were at the start of 2016, despite AT&T's subsequent acquisition of a *~$110 billion company*.

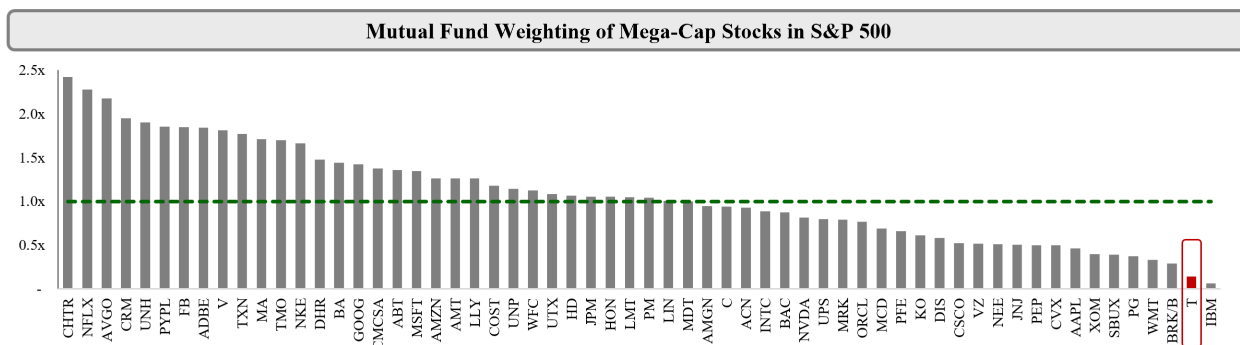


*Source: Bloomberg, Capital IQ as of September 6, 2019.*

For AT&T's managers and the Board charged with overseeing them, missing expectations by this magnitude may cause concern that the team does not have a handle on the business. Worse still, it calls into question whether the managers have the operational capability necessary to track and steer the complex companies under their watch. Given the scale of change that has taken place, such difficulties would not be surprising.

For shareholders, however, this complexity and its attendant challenges have yielded profoundly negative results. It is hard enough for shareholders to evaluate AT&T today – compared to Verizon, Disney, Charter and even Comcast, understanding AT&T's collection of businesses is a daunting challenge. When one adds to this complexity the prospect that management may be overwhelmed and its targets unreliable, one is tempted to give up – and many shareholders have.

Despite AT&T's substantial underperformance and all-time low relative valuation, active shareholders do not support the current AT&T narrative, and many of the world's largest active managers are noticeably underweight AT&T. These shareholders – whose allocations would represent tens of billions of investment dollars even if just equal-weighted – have decided to deploy that capital elsewhere. In fact, of all publicly traded mega-cap companies in the U.S., AT&T is the second-least-owned by active managers.



*Note: Based on holdings of US large cap active fund managers as defined by Thomson Reuters Lipper. Mega-cap defined as >$100bn market capitalization.*
*Source: FactSet. Holdings as of June 30, 2019 and pricing as of September 6, 2019.*

This near-total loss of investor confidence has translated directly into share-price underperformance and a depressed valuation. Investors simply will not give any "credit" to management promises and will heavily discount the likelihood of success:

> *"Attempting to explain why AT&T is trading at an all-time cheap valuation may lead us to the final investor pushback on the AT&T story which is conviction in AT&T's ability to successfully manage these disparate businesses is at an all-time low." – Bank of America, April 2019*

> *"AT&T shares have languished, due, we believe, to concern about the company's video business and the strategy for integrating T's wireless, video, and content assets into a cohesive whole." – Evercore, November 2018*

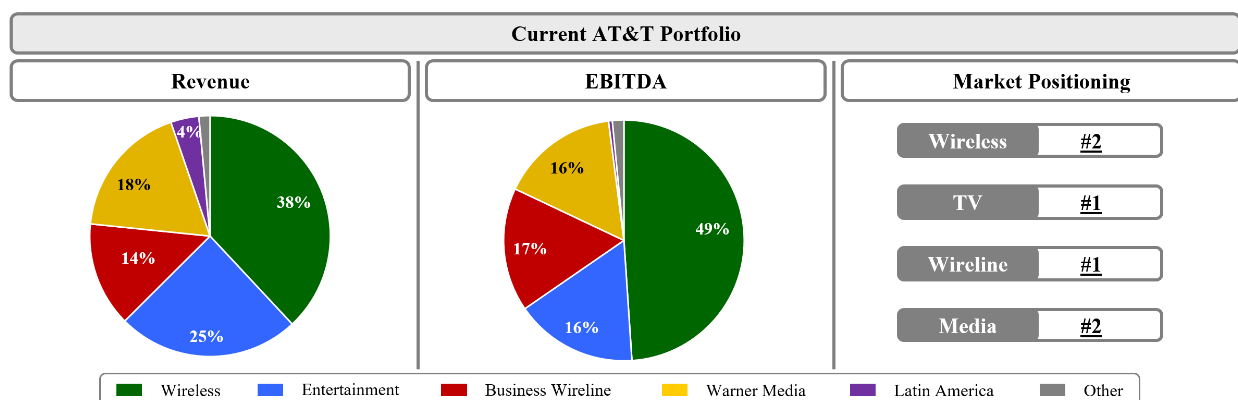
Investor confidence, once lost, is hard to win back. However, such depressed valuations, when found in conjunction with stellar assets, also give rise to unique investment opportunities.

## The AT&T Opportunity

As highlighted above, AT&T has nearly been abandoned by shareholders, and understandably so. However, the truth remains that AT&T has irreplaceable assets, enormous earnings power and an ability to win in key markets. Particularly when coupled with a depressed valuation that assumes no changes will be made, we believe AT&T presents as a uniquely attractive business and investment opportunity.

*AT&T is a Collection of Leading Franchises*

In a world of exponentially increasing connectivity, data usage and content consumption, AT&T – despite the setbacks and issues highlighted above – remains important and valuable. With the right execution and oversight, AT&T's businesses can generate significant value.




*Note: Revenue and EBITDA do not include Eliminations and Consolidations.*
*Source: Company filings. Financials are presented as of Q2-19 LTM. Market position as of end of 2018.*

- *Wireless*: AT&T's wireless business today is in the best position it has been in many years – something of the utmost importance given it represents half of EBITDA. Amidst a relatively benign competitive environment, stable ARPU growth, improving churn and

increasing profitability are driving healthy financial performance. At the same time, AT&T's milestone FirstNet deployment has provided improved network performance as well as a large and stable funnel of new customers. Most important, however, is AT&T's promising outlook for the future: **We believe that AT&T is best positioned to be the market leader in 5G**. Accelerated by its FirstNet build, AT&T is differentiated with a strong spectrum positioning (both mmWave and mid-band), highly virtualized and software upgradable network, leading business solutions (both wireless and wireline) and premier IoT franchise. We believe that the upcoming shift to 5G presents a unique opportunity for AT&T to displace Verizon as the wireless market leader, a potential reset of incredible importance, and one which it cannot afford to miss.

- *Entertainment*: The Entertainment business unit is going through multiple customer evolutions, with pay TV subscribers shifting to an over-the-top and on-demand consumption model while legacy voice and DSL subscribers upgrade to IP-based solutions. Despite these ongoing transitions (along with some self-inflicted issues), the Entertainment group is increasing in stability as the customer-base mix shifts to higher-value subscribers, which provides a more sound base for future performance.

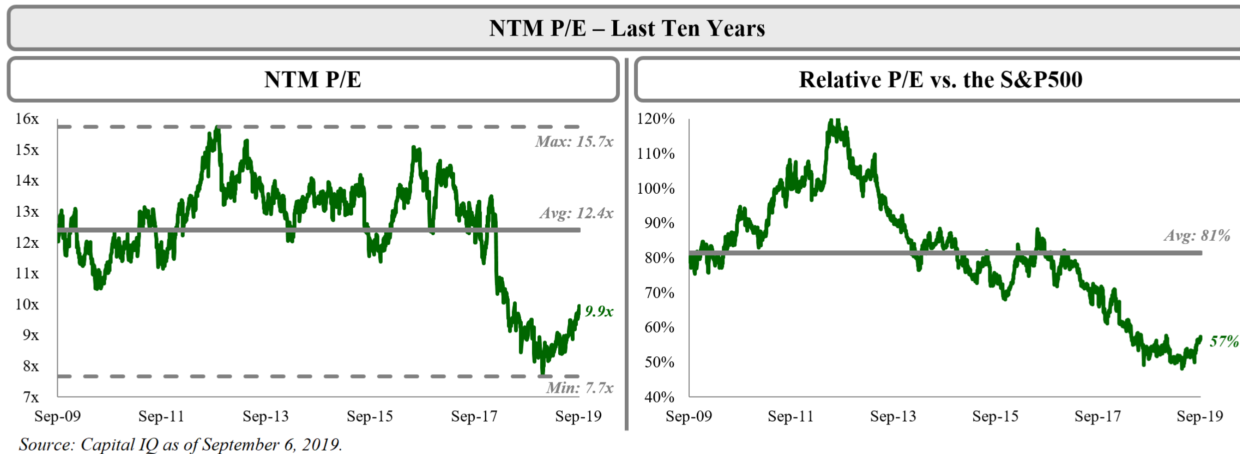
- *Wireline*: While combating the structural challenges associated with legacy voice and data products, AT&T's business wireline unit is improving, fueled by fast-growing strategic and managed services. Last quarter's underlying wireline growth rate was the best in more than three years, and EBITDA exhibited even stronger performance. With its unique global scale, growing fiber footprint, strong presence at the edge and world-leading enterprise brand, AT&T is the only provider capable of meeting the needs of scale businesses for the long term.

- *WarnerMedia*: As mentioned above, WarnerMedia is one of the world's premier media franchises. As a leader in film and TV production, the foremost premium network and a premier collection of cable networks, WarnerMedia has all of the pieces to be highly successful. Given its strong brands and industry-leading content, WarnerMedia is especially well suited for the evolving world of direct-to-consumer consumption.

*AT&T is Deeply Undervalued*

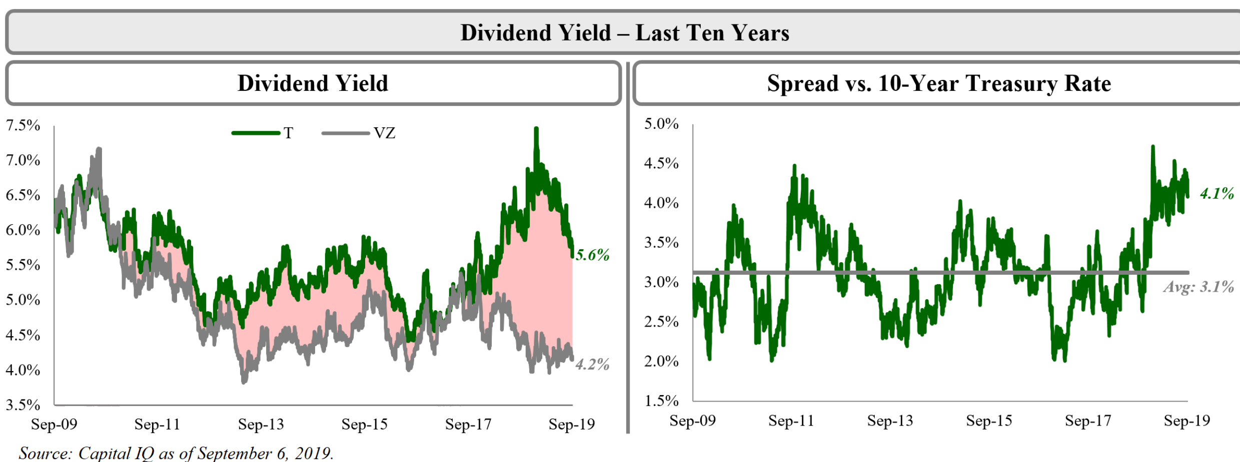
Despite this tremendous potential, AT&T stock is historically cheap. As noted above, AT&T's core telecommunications businesses are actually performing well and are well positioned for the future. Unfortunately, the poor results at (the much smaller) DirecTV and general concern about the Company's ability to execute have obfuscated this otherwise-strong positioning.

As a result, AT&T's valuation multiples relative to its own history, relative to the S&P 500 and relative to Verizon are as low as they have been in many years:




*Source: Capital IQ as of September 6, 2019.*

The numbers are clear: Today, AT&T trades at just 9.9x P/E, a 20% discount to its historical average of 12.4x. When compared to the broader market, which has enjoyed meaningful multiple expansion in recent periods, AT&T now trades at just over half the multiple of the S&P 500 – by far its biggest discount yet. This discount is particularly startling when considering the impact of Time Warner: AT&T acquired a ~$110 billion business for nearly 20x P/E, yet today its own multiple is roughly half that.



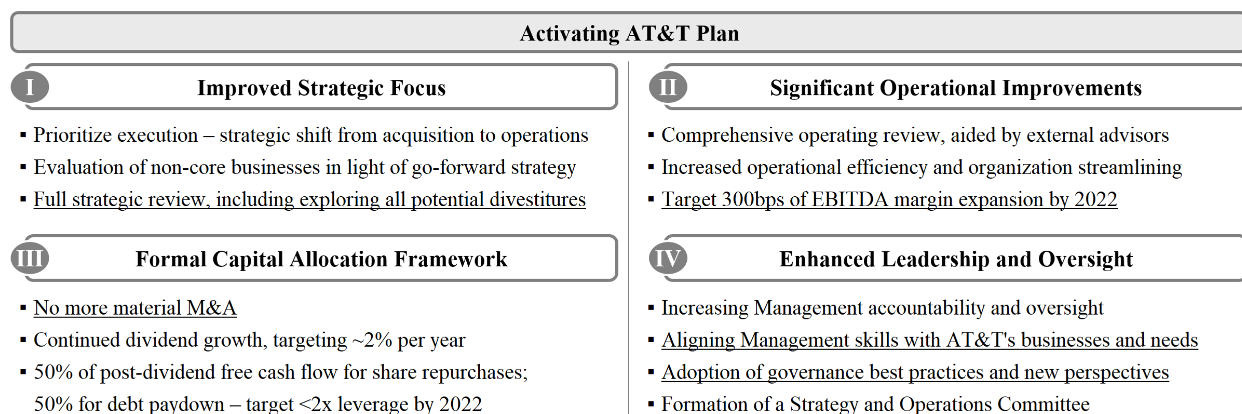

*Source: Capital IQ as of September 6, 2019.*

Similarly, AT&T's ~6% dividend yield presents a uniquely attractive opportunity in today's low rate environment. The spread relative to Verizon has widened meaningfully, and today's more than 4% premium to the 10-year Treasury rate represents its widest spread yet.

Though the last decade has been a challenging period in terms of shareholder value, the next decade need not be. AT&T has highly valuable assets that can drive value creation – #1 or #2 positions in wireless, wireline, pay TV, and content creation and distribution. In our view, <u>the potential of AT&T's leading assets combined with its undemanding valuation makes for a uniquely powerful upside opportunity</u>. What AT&T and shareholders need now is the right plan and a team intent on delivering it.

## Focus and Execution: The Activating AT&T Plan

The Activating AT&T Plan (the "Plan") is premised upon immediately instituting strategic focus and operational discipline. By divesting non-core assets; reducing operational inefficiency; instituting capital discipline and aggressively de-levering; and enhancing leadership and oversight, AT&T can improve its business and deliver historic value creation for all stakeholders. The Plan is comprised of four parts:




## I. Improved Strategic Focus

The first step in the Plan is a full review of AT&T's portfolio, including an analysis of which businesses AT&T must prioritize today and which businesses are distractions and should not be part of the portfolio. The review should include a full analysis of the Company's myriad distribution and content assets – wireless, wireline, satellite, film, TV, advertising and others – so that AT&T can implement (and articulate) a cogent and focused business strategy.

*Prioritize Execution*

A key underlying premise of this step is that AT&T must undergo a strategic shift away from acquisition and toward execution. Even aside from the questionable strategic fit of its M&A, AT&T has spent far too much of the past decade in acquisition mode. Acquisitions require a significant allocation of time and resources – both capital and employee time – that AT&T has been unable to spare.

Beyond just the organizational distraction, this constant barrage of M&A leaves investors (and employees) in a state of wondering "what's next," especially given AT&T's history of stacking acquisitions in close succession. Iusacell and Nextel Mexico were both announced in the time between signing and closing the DirecTV acquisition, while the acquisition of AppNexus was announced just weeks after completing the Time Warner deal.

Focused execution now is critical given the numerous time-sensitive initiatives across AT&T – including the ongoing 5G rollout, WarnerMedia direct-to-consumer offering, pay TV stabilization and others – and this sense of urgency is driving our call for AT&T to take action today.

*Divest Distraction*

As part of its strategic review, AT&T must also look to divest businesses that are not core to this new strategic focus. The potential value creation to be unlocked through dispositions is beneficial on multiple fronts: AT&T will be able to generate meaningful proceeds today that can be used to both repay debt and invest in its highest-value strategic initiatives. However, the value is far greater than just financial, as this exercise will enable management to focus both attention and resources on its most important business lines.

We do not want to preordain the results of this review, but it is clear that AT&T has numerous valuable-yet-non-core franchises that would be potential candidates for divestment, either as assets sold for cash or spun-off alone or in combination. These include the well-known examples of its home security business, regional sports networks, CME, Sky Mexico, Latin American pay TV business (Vrio), Puerto Rican operations and many, many more. AT&T has taken some early steps in this direction, but more needs to be done.

However, this review should not be limited to "smaller" businesses: *Any* assets that do not have a clear, strategic rationale for being part of AT&T should be considered for divestment: DirecTV, the Mexican wireless operations, pieces of the wireline footprint, and other assets must all be evaluated as part of this review. Several of these larger assets are no longer complementary with the Company's future strategic direction, and AT&T must determine whether there is a financially and strategically attractive path to divesting them.

There are numerous major portfolio actions that AT&T can take to unlock value, all of which should be thoroughly explored. While we look forward to sharing our initial views with the Board, the critical step is for AT&T to fully and formally embrace this review process today.

**II. Significant Operational Improvements**

To address operational performance, we believe AT&T should immediately initiate a review of its operations aided by third-party advisors. The review should evaluate all functional areas and business units of AT&T's operations and organizational structure, with a focus on eliminating inefficiency and creating a faster-moving organization.

*Efficient Operations Drive Better Management*

Making AT&T's operations more efficient would provide benefits that go well beyond higher profit margins. While unsurprising for a former regulated monopoly which many still liken to the federal government, AT&T suffers from a bureaucratic organization. By eliminating duplicative layers, reprioritizing wasteful spend and focusing the organization on the most important tasks, we (and our team of consultants) have found that companies grow faster. They accomplish this by focusing management attention on the areas that matter, re-prioritizing key talent and freeing up capital to invest in growth opportunities. In addition to these benefits, optimizing the cost structure allows companies to increase their competitiveness for new and existing business.

For AT&T, having a cost structure that is competitive with peers' and which enables the maximum amount of capital to be invested in key areas is going to be critical to winning in its markets. There are a number of promising initiatives that will require heavy investment over the coming years. By eliminating wasteful spending and reprioritizing a portion of those dollars towards these high-potential investment priorities, AT&T will ensure that its attention and resources are properly directed and best position itself for future success.

*Areas for Improvement*

With the help of our consultants and industry executives, we have identified opportunities for improvement across AT&T and all of its component businesses. In total, <u>the Plan calls for a 36% adjusted EBITDA margin in 2022, representing 300bps of EBITDA margin expansion over the next three years</u>.

While we have identified opportunities for savings well in excess of $10 billion, this 300bps target only represents a net cost reduction of $5 billion and was conservatively designed to encourage AT&T to identify savings to invest into growth areas. While we look forward to sharing more details with the Board, some selected opportunities are below:

- *SG&A:* AT&T's organization is unnecessarily complicated and inefficient, including a management layer that can be streamlined by reducing spans and layers and title proliferation. Many functions – including finance, HR, marketing, sales, legal and others – are much larger than benchmarks (up to as much as 2x to 3x peer ratios) and have the opportunity for rightsizing and simplification.

- *Network Operations:* While AT&T's operations are guided by industry-leading engineers and technicians, AT&T can reduce costs through platform integration and consolidation of residual systems, improved workforce planning and management, and greater usage of self-install and assistance. AT&T would be able to realize cost savings through strategic outsourcing of non-core network functions as well as reduction of stranded overhead, improved field utilization and better leveraging of remote monitoring and maintenance.

- *Retail Footprint and Operations:* AT&T has opportunities to increase flexibility and reduce costs in its retail footprint, including closing redundant stores and increasing labor productivity. AT&T can also evaluate greater use of authorized retailers, an area where it significantly lags competitors today.

- *Third-Party Spend:* Partially as a function of its diffuse and layered management, AT&T has an opportunity to improve procurement management by conducting a detailed review of third-party spend, including content, advertising, leases, backhaul, equipment and others. Improvements include greater centralization of spend, consolidation of the supplier base, tighter governance, and simplifying and de-scoping engagements.

- *Facilities:* AT&T's expansive facility footprint, both personnel offices and network centers, presents a sizeable opportunity for office consolidation and densification of the existing footprint as well as consolidation of central offices. In addition to the benefits of

organizational simplification, many of these facilities are owned, presenting potentially attractive monetization opportunities.

Among the industry consultants, former employees and industry executives with whom we have spoken, a consistent theme emerges: AT&T is inefficiently run. While we look forward to sharing our primary diligence with the Board, a few data points are easily observable. For example, in addition to losing share to Verizon, AT&T's wireless business is also far less profitable than Verizon's. In fact, the profitability gap has actually widened recently: AT&T's wireless service EBITDA margins have always been lower than Verizon's, but last year the gap in service EBITDA margins increased to ~1,500bps on a comparable basis with historical periods, the largest discrepancy to date and a substantial difference in profitability.

Moreover, Verizon continues to aggressively *remove* costs from its operations. These efforts are perhaps most noticeable in the changing trends in company-wide employee counts. While revenue per employee was nearly identical at both companies just over a decade ago (~$400k), today Verizon's revenue per employee (~$900k) is nearly 30% higher than AT&T's (~$700k). And Verizon is continuing to streamline, currently executing against a $10 billion cost takeout program and reducing headcount by more than 10% in the last year alone. By comparison, 300bps of margin expansion at AT&T would represent a net cost reduction of just over $5 billion – a number half as large as Verizon's despite AT&T's roughly 50% larger cost base. While some of the gap in AT&T's profitability may be more difficult to address, our conversations and diligence have identified a material amount of cost differential that can be.

Importantly, wireless is not the only business underperforming its profitability potential. EBITDA margins in the Entertainment Group have *declined* by ~400bps over the past two years on a comparable basis. Such margin degradation would be disappointing in isolation, but it is particularly concerning given that it occurred alongside AT&T's claims to have identified more than $2.5 billion of synergies, or more than 500bps of margin improvement, during the same period. While we recognize the challenging revenue trends in this segment, we have identified a number of areas for further cost rationalization.

*Review Should Commence Without Delay and Include a Long-Term Goal*

While the Company has periodically taken steps to reduce costs, more can be done and with greater consistency and urgency. Rather than piecemeal improvements over time (or as needed to hit certain quarterly targets), AT&T should undertake a bottom-up review of its cost structure and begin executing against a multi-year improvement plan. Importantly, crafting and then executing against a long-term plan gives all employees something to drive towards, which is a far preferable state of affairs compared to one-off actions that leave employees feeling in a constant state of flux.

As AT&T is currently making critical business and capital allocation decisions, it is our strong view that this review should commence without delay.

## III. Formal Capital Allocation Framework

As mentioned above, much of the damage to shareholder and business value at AT&T has occurred due to its capital allocation decisions. A formalized capital allocation framework – in which AT&T makes firm commitments regarding how it will, and how it will not, allocate capital – is an essential part of the Plan. We were encouraged that management recently mentioned exploring share repurchases, which is a good first step. But a formal framework will go much further in conveying a disciplined and underwrite-able approach to the Company's capital.

We recommend four fundamental priorities: 1) focus on current assets and commit not to engage in material M&A, 2) maintain AT&T's highly attractive dividend, 3) increase financial stability through continued debt repayment with a sub-2.0x target, and 4) use ongoing repurchases to enhance shareholder returns.

- *No Material M&A:* It is time for AT&T to manage and maximize its current assets, focusing on core capabilities and investing aggressively behind growth. <u>No additional material M&A should be a part of the Company's use of capital</u>. While there is a natural place in all businesses for the right technology-related or business tuck-in acquisitions, it is time for AT&T to relieve investors of the ongoing fear that there is another major, distracting move coming in the foreseeable future.

- *Dividends:* AT&T should remain committed to growing the dividend as it has for 35 consecutive years. Consistent with recent history, the Plan calls for a <u>~2% annual increase in the dividend</u> to balance income growth with financial flexibility.

- *Capital Return:* After dividends, we believe that AT&T should adopt an equal balance of debt paydown and share repurchases – <u>allocating 50% of post-dividend free cash flow to debt repayment and 50% to share repurchases</u>:

    - *Debt Paydown:* AT&T should continue to aggressively repay debt in order to improve its overall financial positioning. Further, by embracing the operational best practices outlined above, AT&T will reduce leverage in the best manner possible – by growing earnings. Through this combination of debt repayment and meaningful EBITDA growth, <u>AT&T will de-lever to below 2.0x by 2022</u>.

    - *Share Repurchases:* Now is a uniquely attractive time to repurchase shares, as AT&T is trading at its lowest valuation levels since the financial crisis. AT&T should use this opportune time to begin consistently repurchasing shares, capturing both today's value disconnect and the upside of the significant increase in future earnings resulting from the Plan.

When combined with the other elements of the Plan, AT&T will be de-levering and reducing its share count at a time of substantial earnings growth, thereby generating significant value for shareholders. Adopting a formal commitment to how AT&T deploys its precious capital is likely the most important step in restoring shareholder credibility and confidence.

## IV. Enhanced Leadership and Oversight

While we strongly believe that the Plan outlined above will create substantial value for all stakeholders, success is predicated upon having the right team in place to execute and oversee it.

*Aligning Management Skills with AT&T's Challenges*

AT&T has suffered from operational and execution issues over the past decade, for which the current leadership team is accountable. On top of these existing issues, the Company is now a major player in many new verticals where its long history and legacy have little bearing, and it finds itself battling competitors on multiple new fronts – its traditional telecom competitors as well as new challengers in newly acquired businesses.

We've conducted hundreds of interviews with former executives, competitors and partners, all of whom have raised the same question we have: Given AT&T's history of strategic and operational issues and the very different skills needed to manage some of these new businesses, does AT&T have the right mix of leadership at the Company?

There is no greater Board responsibility than to evaluate the skills and experience necessary to lead AT&T, with its current mix of assets, into the future. Especially given the recent management changes, this is the moment to determine the right team for the next decade. For AT&T, its shareholders, customers and employees, the opportunity is too great, and the cost of continued mistakes too high, to get it wrong.

*Maximizing the Impact of the Board*

The Board also bears responsibility for the Company's strategic choices, operational execution and performance. Holding management accountable to make the right decisions and then to execute is at the very core of a Board's duty. This need is doubly pressing at a company like AT&T, for the reasons outlined above.

AT&T's Board is comprised of capable executives, investors and professionals, and we are looking forward to a productive dialogue together. As part of this dialogue, we think it may be beneficial to evaluate the addition of qualified directors with specific domain expertise and operating skills suited for AT&T's challenges today. Thankfully, AT&T is one of the world's premier businesses, whose unique scale, stature and importance afford it the ability to recruit the highest-caliber directors. We have identified several leading candidates that we look forward to discussing with Board.

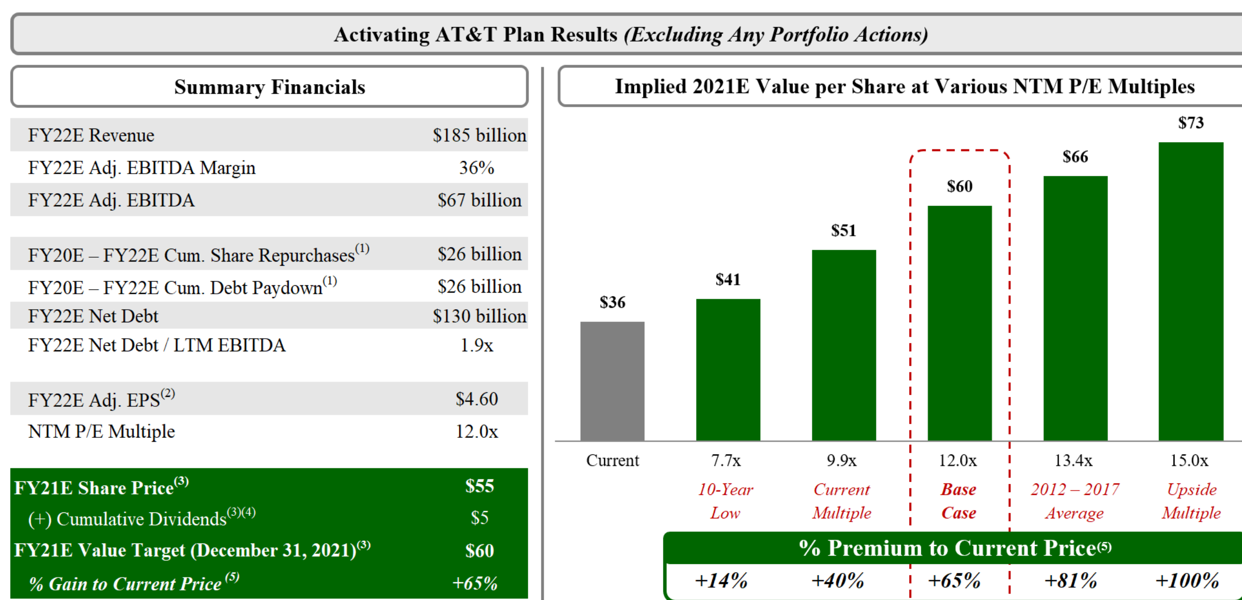
In addition to any potential Board enhancement, AT&T must adopt corporate governance best practices relating to Board oversight and management. The Board must have in place independent leaders who will hold management accountable. AT&T's long-term underperformance suggests that improvement is required, and shareholders are asking for it. Proposals to separate the Chairman and CEO roles have arisen repeatedly at AT&T in prior years, and at this year's Annual Meeting, despite the Board's recommendation "Against" this proposal, **41%** of shareholders who voted on the proposal voted in support of separation.

We also strongly recommend the formation of a Strategy and Operations Committee of the Board. Given the amount of work to be completed across multiple dimensions, AT&T would benefit from having a smaller, dedicated subset of directors specifically focused on overseeing the strategic and operating reviews called for in the Plan. We have observed that such committees have been highly successful in prior situations, as they empower directors to get more involved in the specifics of the planning and execution. Such a committee would also demonstrate to shareholders and employees alike that AT&T is acutely focused on addressing these issues.

## Upside of a Unique Magnitude

Elliott has made a substantial investment in AT&T – among its largest ever – because it exhibits the unique combination of valuable assets, historical underperformance, a depressed valuation and a clear path forward to generate extraordinary value for shareholders and other stakeholders. **We believe that AT&T can achieve $60+ per share of value by the end of 2021, prior to any strategic actions regarding the portfolio**.

Through a combination of greater strategic focus, improved operational execution, balanced capital allocation and enhanced leadership and governance, AT&T can provide exceptionally attractive returns for shareholders while improving its business. This level of potential value creation is unique for any company, let alone one with a market capitalization north of $250 billion.



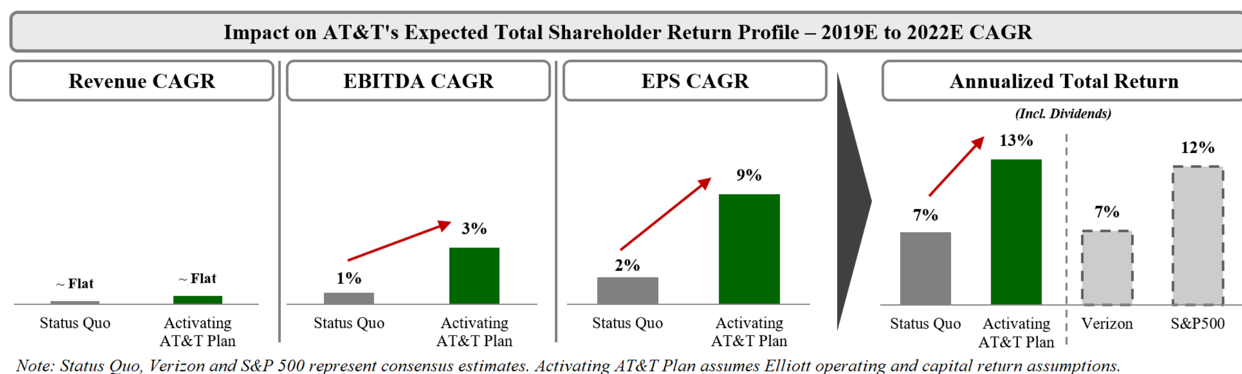
**Activating AT&T Plan Results *(Excluding Any Portfolio Actions)***

| Summary Financials | |
|---|---|
| FY22E Revenue | $185 billion |
| FY22E Adj. EBITDA Margin | 36% |
| FY22E Adj. EBITDA | $67 billion |
| FY20E – FY22E Cum. Share Repurchases(1) | $26 billion |
| FY20E – FY22E Cum. Debt Paydown(1) | $26 billion |
| FY22E Net Debt | $130 billion |
| FY22E Net Debt / LTM EBITDA | 1.9x |
| FY22E Adj. EPS(2) | $4.60 |
| NTM P/E Multiple | 12.0x |
| **FY21E Share Price(3)** | **$55** |
| (+) Cumulative Dividends(3)(4) | $5 |
| **FY21E Value Target (December 31, 2021)(3)** | **$60** |
| ***% Gain to Current Price(5)*** | ***+65%*** |



*Note: Financials assume Activating AT&T Plan operating and capital return assumptions.*
*(1) Assumes post-dividend free cash flow allocated 50% to debt paydown and 50% to share repurchases.*
*(2) EPS rounded to the nearest $0.05.*
*(3) Rounded to the nearest $1.00 per share*
*(4) Assumes quarterly dividend per share increases $0.01 annually.*
*(5) Relative to current share price of $36.25 as of September 6, 2019.*

By executing against the Plan, AT&T will dramatically improve its financial profile. Ongoing margin expansion coupled with debt paydown and share repurchases will drive nearly 10% annual EPS growth. When combined with its attractive dividend yield, AT&T can immediately become a low-to-mid-double-digit value compounder.



*Note: Status Quo, Verizon and S&P 500 represent consensus estimates. Activating AT&T Plan assumes Elliott operating and capital return assumptions.*

Such an attractive financial profile certainly merits a premium to AT&T's current depressed valuation of 9.9x P/E and even its 10-year average of 12.4x P/E. A mid double-digit total return profile would be roughly twice that of Verizon's and even greater than the S&P 500's. Given Verizon's P/E multiple of more than 12x and the S&P 500's of 17x, we believe there is substantial upside beyond the conservative 12x multiple assumed in the Base Case.

Moreover, the figures above exclude any benefit of asset divestitures or portfolio separation. We believe the strategic review will yield major portfolio actions that AT&T can take today, which would rapidly expedite debt paydown or share repurchase activity, none of which are reflected above. When the financial benefits of the Plan are combined with a tightened portfolio, re-focused strategy, commitment to responsible capital deployment, and enhanced oversight, the potential is even greater than the numbers shown above. Such steps would drive a more focused operation and, we believe, superior revenue growth that could generate further upside to the 65% we reflect on a purely operational basis.

The upside at AT&T is made even more attractive by its highly defensive profile: the high dividend yield, subscription-based business models, inexpensive valuation, domestic revenue base, strong cash flow generation and mission-critical assets.

*A Stronger AT&T*

Beyond just delivering a higher stock price for its shareholders, both institutional and employee, we believe a more focused and efficient AT&T can deliver far-reaching benefits to other stakeholder groups as well. From consumers who turn to AT&T for their phone calls, internet, television or content, to businesses that depend on the Company to connect employees, suppliers, partners and customers, AT&T makes daily life possible for hundreds of millions of people.

By successfully executing on its ongoing initiatives – such as winning in 5G, improving broadband connectivity, and building a robust direct-to-consumer offering – AT&T will continue to improve the lives of these individual customers and businesses, all of whom are served by nearly a quarter of a million hard-working AT&T employees. In addition, a successful AT&T will enable the United States to remain a global leader in telecommunications, a position the country has held since the telephone was invented and in which this Company has played a central role. Much is riding on AT&T's long-term prosperity, and we believe the Plan outlined above – especially its

emphasis on fewer distractions and greater focus on running AT&T's mission-critical businesses as well as possible – is the best way to ensure that this goal is met for generations to come.

We are confident in the value opportunity for shareholders and stakeholders alike; believe the Plan is readily actionable today; and look forward to working with management and the Board in order to make this opportunity a reality.

**Next Steps**

Today AT&T is at a pivotal inflection point in its storied history. While it has a premier set of franchises, each with a leading market position, AT&T's operational and strategic issues have weighed on both financial results and investor confidence. Fortunately, these issues are addressable, and there is a path forward to realize unique value for all stakeholders.

AT&T should now place its greatest emphasis on operations – it must move past the era of asset accumulation and into one of integration and execution. Through a focused strategic review, emphasis on operational best practices, a formal capital allocation framework, and enhanced leadership and oversight, AT&T has a unique opportunity to reverse the past decade of underperformance and embark upon a new period of extraordinary value creation. Beyond the significant share-price upside, the business benefit – to again see a strong and thriving AT&T for customers, employees and everyone who depends upon this Company – is also clear. If done successfully, the opportunity is historic.

We want to personally thank the Board for considering our thoughts, and we are looking forward to hearing yours as well. While this letter has been necessarily candid in its analysis of the recent past, we are at this point completely focused on AT&T's future and believe we are fully aligned with you in wanting to build sustainable shareholder value and create a stronger AT&T for all. As a next step, we respectfully request a near-term meeting so we can begin the process of working together to pursue this opportunity.

Best Regards,

Jesse Cohn
Partner

Marc Steinberg
Associate Portfolio Manager