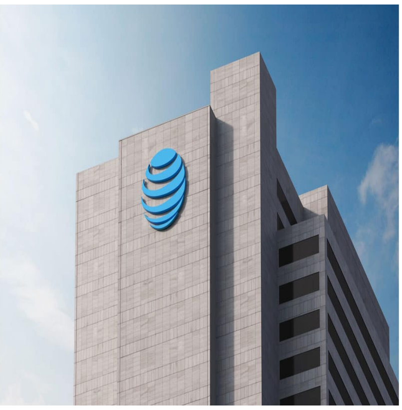

Activist Investor Elliott Wants Changes at AT&T

Description

Shares of **AT&T** (NYSE: T) jumped yesterday morning on news that activist investor Elliott Management had taken a $3.2 billion stake in the telecommunications and media giant. The hedge fund has penned an open letter to AT&T's board of directors, outlining its thesis on why AT&T shares are severely undervalued and how the company can better maximize shareholder value. Elliott goes so far as to say that the stock could be worth $60 by the end of 2021 — 65% higher than Friday's closing price.

Here's what investors need to know.

AT&T shares are cheap

Elliott points to a number of strategic mistakes that have contributed to AT&T's underperformance relative to the broader market over the past decade. The institutional investor criticizes the company's acquisition strategy, noting that it has spent nearly $200 billion and "built a diversified conglomerate by pushing into multiple new markets," most notably including the $67 billion purchase of DirecTV and the $109 billion acquisition of Time Warner.

This acquisition strategy has "not only contributed directly to [AT&T's] profound share price underperformance, but has also caused distractions that have contributed to the Company's recent operational underperformance," in Elliott's view.

Ma Bell has also had product-related missteps. The company has not executed well in rolling out over-the-top (OTT) streaming services, which have suffered from delays and technical problems. The streaming strategy is a mess, and AT&T has changed direction numerous times. Still, Elliott believes a turnaround is possible, since AT&T has "irreplaceable assets, enormous earnings power and an ability to win in key markets."

AT&T shares are trading at extremely cheap valuation multiples — around 9.9 times forward earnings. That's a discount to AT&T's historical average as well as to the broader market. The low share prices are also pushing AT&T's dividend yield higher, which at 6% is "a uniquely attractive opportunity in today's low rate environment," Elliott says.

Stop acquiring, start selling

Elliott wants AT&T to commence a formal review and divest noncore assets in order to improve strategic focus, reduce operational inefficiencies, and reduce debt. The company's debt load has been ballooning from all of the blockbuster acquisitions, and divestitures can create significant value. Candidates for divestiture include DirecTV, wireless operations in Mexico, regional sports networks, and the home security business, among others.

The company should also stop making large acquisitions in order to improve capital allocation, which in turn would help support future dividend increases. Elliott further suggests that AT&T allocate half of post-dividend free cash flow to paying down debt, with the remaining half going toward share repurchases.

"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," Elliott writes. "Fortunately, these issues are addressable, and there is a path forward to realize unique value for all stakeholders."

AT&T has issued a statement in response to Elliott, saying that it will "review Elliott Management's perspectives in the context of the company's business strategy." The company says it looks forward to engaging with the activist investor and is already pursuing "many of the actions" outlined in the letter.

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