

## Optima Investment Research

111 West Jackson Blvd.  
15th Floor  
Chicago, Illinois 60604  
Phone: (312) 427-3616  
Fax: (312) 427-9840  
Toll Free: 1-800-344-4403  
E-Mail: [optima@oir.com](mailto:optima@oir.com)

Web: [www.oir.com](http://www.oir.com)  
Bloomberg: OIR <Go>

## AT&T Wireless Group

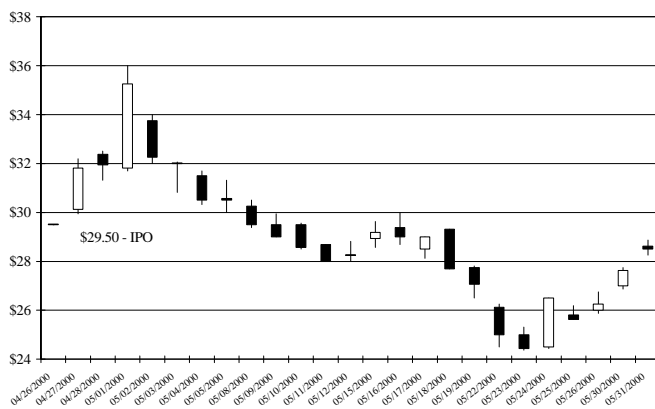
Industry: Wireless/Cellular Telecommunications

**AWE: Initiating coverage with a new Buy rating.**

**Description:** AT&T Wireless Group is the tracking stock of AT&T's wireless operations. The new entity has one of the most widely recognized brand names in the telecommunications industry and is the second largest wireless communications provider in the US with over 13 million subscribers as of Q1. Due to its large market capitalization, AT&T Wireless Group will likely become the benchmark for investors wishing to participate in the wireless industry's surging growth. Q1 2000 revenue rose 41% y/y to \$2.198 billion.

June 1, 2000

AT&T Wireless Group - Daily Chart



## Overview

AT&T sold 360 million shares of its AT&T Wireless Group tracking stock on April 26th at \$29.50 per share, raising \$10.600 billion in the process. It was the largest IPO in US history, nearly double the previous record set by UPS (\$5.470 billion) in November 1999. Globally, it was the sixth largest IPO ever. The unit includes AT&T's voice and data wireless businesses, overseas interests in wireless companies, and wireless operations that provide local phone service. The sale represented 15.6% of parent-company AT&T's interest in the entity. There are a total of 2.310 billion shares outstanding, giving AT&T Wireless a market capitalization of \$60.638 billion as of late May. AT&T's Board of Directors is

## Market Data

Market Cap.	\$60.638 Bln	52W High (5/1/00)	\$36
Shares Out	2.310 Bln	52W Low (5/23/00)	\$24-3/8
Trading Float	360 Mln	Dividend Yield	N/A
Last Price (5/31/00)	\$28-9/16	FY 2000 Earnings (Est.)	(\$.04)
Avg. Daily Vol.	8.5 Mln	Consensus (1 sell/5 buy)	4.6

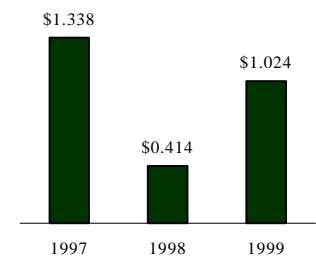
## Financial highlights (FY 1999)

Sales (\$ Billions)	\$7.627	Earnings Per Share	(\$.20)
Y/Y Sales Growth	+41%	Gross Margin	49.6%

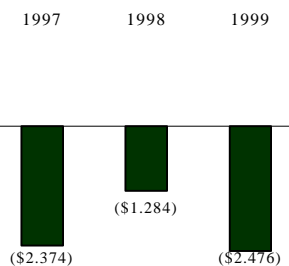
Revenue (\$ Billion)



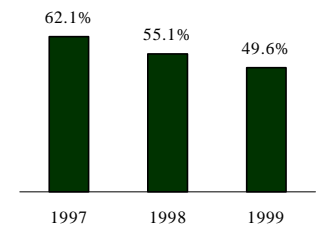
Cash From Operations (\$ Billion)



Total Capital Expenditures (\$ Bln)



Gross Margin



expected to announce in the second half of this year how the remaining 1.950 billion shares will be distributed. The plan will likely entail some form of a stock swap and dividend to holders of AT&T common stock.

Of the IPO's proceeds, \$7 billion will go to AT&T Wireless where it will be used for investment in its wireless network, partnership development, acquisitions, and capital spending. In addition, AT&T Wireless is expected to participate in a round of FCC wireless license auctions that will be held this summer. Those auctions are expected to net the government \$10 billion. The balance of the IPO's proceeds (about \$3.3 billion), will go to AT&T for general corporate uses and underwriting expenses.

By issuing a tracking stock, parent-company AT&T maintains control of its wireless unit while at the same time permitting investors to value the business as a separate entity. Sprint took a similar route in November 1998 and its wireless PCS Group's shares have since widely outperformed Sprint FON Group whose principal activities are offering long-distance and local telephone service.

### Valuation

AT&T Wireless hit the market near the bottom of the technology sector's sell-off which began in early March. The decline was particularly ruthless in the wireless industry which witnessed strong gains in 1999. Spe-

cifically, the S&P Cellular/Wireless Telecommunications Index rose 223% in 1999 and by another 39% in early-2000 to its all-time high on March 27. However, the index then fell sharply by one-third in April and May. Nonetheless, the AT&T Wireless IPO on April 26th went off at the middle of its expected price range (\$26-\$32). Despite the enormity of the sale and the adverse market conditions, demand was strong and the deal raised nearly as much money as expected.

Investors have been using earnings before interest, taxes, depreciation and amortization (EBITDA) to value companies like AT&T Wireless which are spending huge sums of money to build communications networks. Relative to its peers, AT&T Wireless appears appropriately priced. The shares were sold at a price about 60 times 1999 cash flow which compares favorably to Nextel (67 times cash flow) and the ADR's of Vodafone AirTouch (59 times cash flow), the world's largest mobile-phone company. AT&T Wireless is trading with a much lower book value (3.0) than Sprint PCS (16.7) and Nextel (15.1).

### Business Review

AT&T Wireless' revenues have been soaring but expenses and investment costs have recently risen even faster. In fiscal-year 1999 (which ended in December 1999), total revenues at the wireless unit rose 41% y/y to \$7.627 billion but FY 1999 total expenses rose 44% y/y to \$8.293 billion. AT&T spent \$2.476 billion on its wireless

### Selected Peer Group Companies With Publicly Traded Stock

Peer	Symbol	Recent Price	Market Cap (\$ Millions)	Consensus: 1 sell / 5 buy	12-M Trailing PE	Beta	1-year Total Return (%)	Yield (%)	Est. EPS (\$)
Alltel	AT	60	18,823	4.9	23.3	.77	(10.7)	2.04	2.71
Bell Atlantic	BEL	51-11/16	80,954	4.6	17.1	.72	(2.0)	2.94	3.30
Broadwing	BRW	23	5,097	4.4	66.3	.97	(1.3)	N/A	(.95)
GTE Corporation	GTE	61-3/8	59,931	4.7	17.5	.66	1.4	3.00	3.79
Nextel	NXTL	82-1/8	34,220	4.8	N/A	1.32	144.8	N/A	(2.90)
SBC Communications	SBC	42-5/8	149,463	4.5	19.8	.88	(12.3)	2.31	2.29
Sprint PCS	PCS	53-1/2	49,879	4.7	N/A	N/A	142.2	N/A	(2.55)
US West	USW	70-11/16	36,204	4.2	21.2	.74	37	3.00	3.36
Vodafone AirTouch	VOD	42	282,305	4.4	25.5	1.07	20.5	.50	.63
VoiceStream Wireless	VSTR	100-3/8	23,430	4.7	N/A	N/A	302.8	N/A	(5.00)
WorldCom	WCOM	37-3/16	109,512	4.8	25.1	1.00	(33.6)	N/A	1.90

operations last year (twice as much as 1998) to build and expand its network. In FY 2000, those expenses are expected to rise to \$4.100 billion and remain high in the following years. In FY 1999, AT&T's wireless operations lost \$461 million compared to a \$108 million profit in 1998.

In Q1 2000, AT&T reported that revenue from its wireless operations rose 41% y/y to \$2.198 billion. Earnings before interest, taxes, depreciation and amortization (excluding other income) more than doubled y/y to \$401 million. After those deductions, however, wireless operations likely showed a loss in Q1. In any case, AT&T did not break out those results.

Currently, consensus analyst expectations point to a four cent per share loss in FY 2000 and a ten cent per share profit in FY 2001. Expectations for a loss this year are centered on the heavy costs of building its wireless network. Cash flows, however, are expected to keep rising as subscriber growth remains strong. In early May, the company said that it expects cash flow to rise 45% y/y this year, up from earlier estimates of 40%.

In a positive sign, AT&T Wireless is earning more revenue per customer. As of Q1, almost 85% (compared to 67.5% in the year-ago quarter) of AT&T Wireless' subscribers had been switched over to digital services which afford more efficient use of the wireless network and a lower subscriber loss rate. This raised Average Revenue

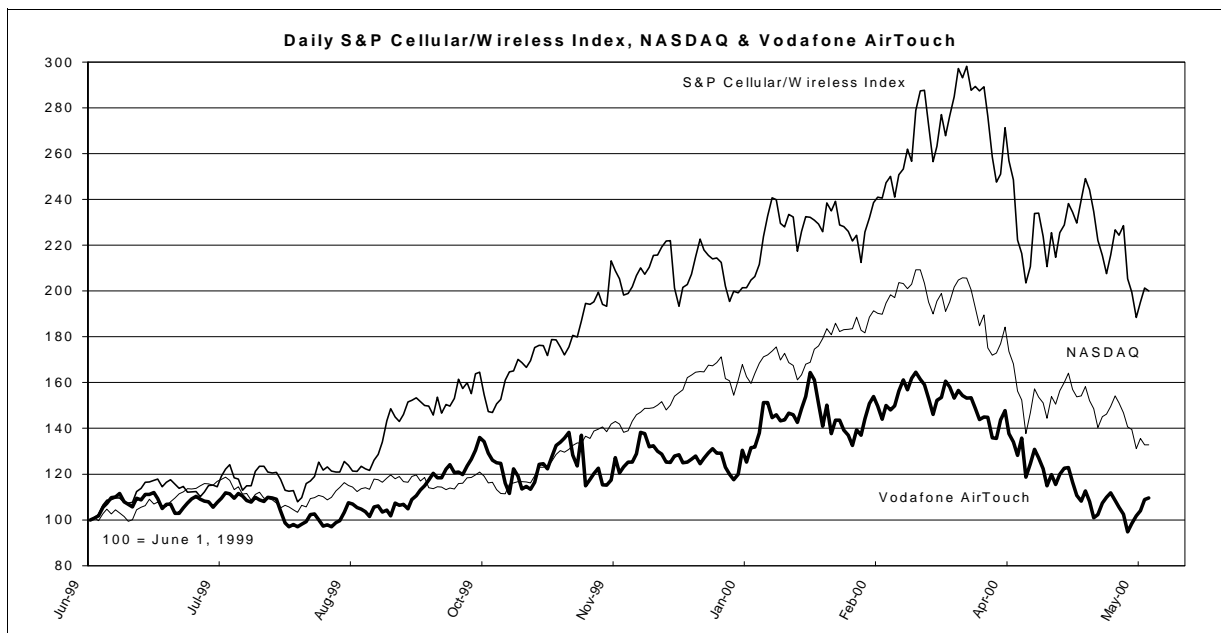
Per User (ARPU) in Q1 to \$67.20, up 10.5% y/y.

**Industry Outlook**

Subscriber growth in the wireless business has been very strong and is expected to expand industry-wide by about 25-30% in 2000. Last year, the number of wireless phone users rose by 16.8 million, the single largest yearly gain to date for the industry. There were 86.1 million wireless subscribers (a 24% y/y gain) last year or about one in every three Americans, according to the Cellular Telecommunications Industry Association. Not only are the number of wireless customers growing quickly, but those customers are also using their phones more heavily. In 1999, wireless phone customers used their phones an average of 180 minutes per month, a 38.5% y/y gain, according to the trade group. Usage has been rising as prices fall and as new applications emerge for wireless networks. AT&T set the trend towards lower prices in motion in May 1998 when it announced a flat-pricing plan and eliminated roaming charges.

The wireless communications market has been difficult from a profit standpoint thus far due to the cost of huge network investments, declining prices, and active competition for market share. However, there are hopes for a turnaround as usage per subscriber rises with the growing use of wireless networks for e-mail and Internet traffic. In addition, the fast-growing wireless firms should benefit from economies of scale and lower equipment costs

The chart below shows the S&P Cellular/Wireless Index (Sprint PCS & Nextel) plotted against the NASDAQ Composite Index and the American Depository Receipts of Vodafone AirTouch Plc, the largest wireless company in the world. The wireless stocks enjoyed huge gains last summer and fall that actually outpaced the tremendous rally seen overall in the technology sector as represented by the NASDAQ. In March, however, valuations had clearly gotten out of hand and a steep sell-off ensued. The sector recently got a boost from Vodafone AirTouch's fiscal 2000 earnings report which showed a profit and a 54% y/y gain in subscribers. Recent news that NTT DoCoMo is in talks to buy 20% of VoiceStream for about \$4.7 billion has also provided support to the industry.



on a per-user basis.

The wireless communications industry is going through a wave of consolidation and alliance building as companies seek entry into the business and as larger players seek to extend their reach and lower their costs. For example, Verizon Wireless was formed through an alliance between Bell Atlantic and Vodafone Airtouch. SBC Communications and BellSouth have also reached agreement on plans for a nationwide wireless network. Both of these deals represent an attempt to cut costs, establish coast-to-coast coverage, and increase market share. The resulting companies of both of these deals will likely end up as IPOs.

Worldcom is trying to buy Sprint (and Sprint's wireless operations, Sprint PCS) for \$140 billion although that deal has met serious resistance from the US Justice Department and from EU authorities. If that deal does not go through, Worldcom will likely try to pursue its wireless strategy by either bidding in this summer's wireless auction or possibly buying Voicestream or Nextel. Japan's NTT DoCoMo, the wireless unit of Nippon Telegraph & Telephone, is currently in talks to buy a stake in VoiceStream Wireless.

### The Outlook for AT&T Wireless

AT&T Wireless has several positive factors that deserve investors' attention. First, AT&T has the most recognized brand name in the telecommunications industry and has a strong reputation for quality among consumers and business customers. Combined with the highest stock market capitalization in the US wireless industry, AT&T Wireless will likely become the benchmark issue for investors.

Second, owning AT&T Wireless allows participation in a very fast growing business. Wireless phone subscriber growth rates are surging and will likely continue to grow rapidly as more applications for the networks are put to use. At AT&T Wireless, this translated into 41% growth in revenue in FY 1999. In the all important drive for market share, AT&T's wireless network is the second largest in the US based on 13 million subscribers at the end of Q1 2000 (+30.2% y/y) and has been adding users at a rapid pace. In Q1 alone, AT&T Wireless added 418,000 subscribers which represented a 12.3% y/y gain.

Third, the AT&T Wireless network is nationwide in scope, an advantage that other companies are scrambling to achieve through alliances and mergers. AT&T Wireless' network covers 70% of the US population and has licenses that cover 94% of the population, including 42 of the 50 largest metropolitan areas. This type of coverage frees AT&T Wireless from having to rely on roaming partners which drives its per-call expenses higher.

Balance Sheet (\$ Millions)	1997	1998	1999
<b>Assets</b>			
Current Assets	NA	1,238	1,628
Systems/Equipment	NA	7,658	10,127
Land/Buildings	NA	222	255
Depreciation	NA	(2,698)	(4,033)
Licensing Costs	NA	7,928	8,571
Investments	NA	3,795	4,502
Goodwill/Other	NA	1,317	2,462
Total Assets	NA	19,460	23,512
<b>Liabilities &amp; Equity</b>			
Current Liabilities	NA	1,626	2,297
Long-Term Debt	NA	2,500	3,400
Deferred Taxes	NA	3,662	3,750
Other Long-Term Liabilities	NA	140	68
Total Liabilities	NA	7,928	9,515
Total Equity	NA	11,532	13,997
Total Liability & Equity	NA	19,460	23,312

Income Statement (\$ Millions)	1997	1998	1999
Service Revenue	4,249	4,779	6,823
Equipment Revenue	419	627	804
Total Revenue	4,668	5,406	7,627
Network/Service Cost	1,770	2,428	3,846
Depreciation/Amortization	826	1,079	1,253
Selling/General/Administration	1,982	2,122	2,663
Impairment/Restructuring	160	120	531
Total Expenses	4,738	5,749	8,293
Other Income	288	764	176
Interest Expense	0	(120)	(136)
Income Before Taxes	218	301	(626)
Income Taxes	93	137	(221)
Income After Taxes	\$125	\$164	(\$405)

### Summary

Due to the above factors, we believe that AT&T Wireless is well positioned to take advantage of the burgeoning US wireless communications market. Moreover, the stock is now attractively priced after the recent sell-off in the wireless sector. Coverage is therefore initiated with a buy recommendation.