

AT&T's DirecTV Deal Seen Helping Laggard Finally Outpace Verizon

by Scott Moritz

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AT&T Inc., a long-time laggard behind Verizon Communications Inc. in sales and share performance, is outpacing its larger rival on both metrics.

Results for both companies this week will show whether AT&T can pull further ahead.

AT&T is projected to boost sales faster than Verizon for the next 10 quarters, and it's about to close a satellite-TV acquisition that will make it the top pay-TV provider in the U.S. while helping it bore deeper into Latin America.

Verizon, by contrast, is narrowing its focus on mobile products with the \$4.4 billion acquisition of AOL Inc. Investors and analysts are awaiting details of a new mobile-video service from Verizon featuring live broadcasts and on-demand movies.

"There's certainly a lovefest around AT&T right now," said Jennifer Fritzsche, an analyst with Wells Fargo & Co. in Chicago. "Verizon knows what they're doing; they just need to express their vision."

In the last three months, AT&T's shares are up 7.7 percent, while Verizon's have fallen 2.7 percent. At least four analysts have upgraded AT&T's shares since June. The optimism has centered on projected revenue benefits and cost savings of the \$48.5 billion purchase of DirecTV, due to close in the coming days. Aside from new products and a bigger toehold in Latin America, DirecTV also gives AT&T added cash flow for dividend payouts.

The new AT&T will have a 3 percent to 4 percent increase in sales growth over the next two years, compared with a 0 percent to 1 percent estimated for Verizon, according to analyst estimates.

"Verizon hasn't articulated a strategy," said Kevin Smithen, an analyst with Macquarie Securities USA Inc. "At least AT&T knows what it wants to be when it grows up." Smithen recommends an equivalent of a sell on Verizon, the lowest rating among U.S. analysts tracked by Bloomberg.

'All Wireless'

Lowell McAdam, Verizon's chairman and CEO, set the course to an all-mobile future with a \$130 billion buyout of partner Vodafone Group Plc in February 2014.

During that acquisition process, McAdam began a review of the company's legacy telephone assets, part of an effort to raise cash, pay down debt and buy wireless airwaves. Verizon has sold landline operations in three states and \$15.6 billion worth of property rights to more than 11,000 cell towers.

McAdam has said he doesn't share AT&T's interest in satellite TV. Last month Verizon bought AOL to enhance its ad-placement technology as it moves into mobile-video services.

"If he had it his way, Lowell would make Verizon an all-wireless company," Wells Fargo's Fritzsche said. Verizon gets about 70 percent of its total revenue from wireless; AT&T gets 56 percent.

The strength of Verizon's wireless-centric strategy will be under scrutiny Tuesday as the company reports second-quarter results. By dangling cheap tablets, Verizon will have added about 1 million new subscribers, according to a Bloomberg survey of seven analysts. AT&T, which reports results Thursday, is expected to have added less than half of that.

Yet analysts also project an annual sales decline for Verizon. After reaching 3 percent top line growth this year, the pace slows to 1 percent next year and no growth in 2017. AT&T is estimated to rise from 3 percent sales growth this year to 4 percent next year and 3 percent in 2017.

Strategic Disparity

AT&T and Verizon had historically moved in tandem. They both started as regional phone companies that got bigger by buying other regional phone companies. They both added wireless units, then expanded into broadband and TV-service bundles. Now, with Verizon's takeover of AOL and AT&T's takeover of DirecTV, the two have split apart.

As early as this month, Verizon will start an Internet-based, mobile-TV service featuring live shows, video on demand, original programming and sporting events for people to watch on phones, tablets and televisions. AT&T will continue to expand into Mexico and other parts of Latin America with its acquisitions earlier this year of Grupo Iusacell SA and Nextel Mexico.

But not everyone on Wall Street sees AT&T supplanting Verizon. Todd Lowenstein, a money manager with Highmark Capital Management, says that of the two strategies, he likes Verizon's most. AT&T is

responding to today's challenges with DirecTV while Verizon is targeting a long-range growth opportunity, he said.

Verizon's strength is its wireless network, the platform necessary for exploring services like mobile video with both a subscription and ad-supported model, he said. Highmark holds positions in Verizon as part of its \$16 billion in assets under management.

"I like their focused strategy of consolidating the Vodafone stake and taking a mobile-first approach to attacking the market," Lowenstein said of Verizon.