Analysis on financial statements economics essay

ATandT Inc. (NYSE: T) is a United States telecommunications corporation headquartered in Texas. Founded in 1983 as SBC Communications, it became AT&T Inc. upon purchase of AT&T Corporation in 2005. It is the leading U. S. provider of wire-line and wireless communications. AT&T delivers 3G wireless services through AT&T Mobility LLC, a wholly-owned subsidiary. Other major segments include broadband internet, digital television, directory publishing, and business communications.

In 2006, AT&T Inc. acquired BellSouth communications corporation, valued at $86 billion, absorbing its wire-line, wireless, and broadband interests. AT&T has stated specific future goals in 4G wireless, speech recognition, telehealth, and digital convergence. Recently, AT&T selected Alcatel-Lucent and Ericsson as equipment providers for its LTE (4G) wireless deployments. AT&T has over 150 million customers and 280, 000 employees. AT&T reported a $124 billion operating revenue and $23 billion net income as of Dec. 31, 2008.

Verizon Communications Inc.(NYSE: VZ) is a United States telecommunications corporation headquartered in New York. It was founded in 1983 as Bell Atlantic. Bell Atlantic acquired GTE Corp. in 2000 and changed its name to Verizon Communications Inc. It is the second largest U. S. provider of wire-line and wireless voice services. Verizon Wireless is a joint venture, with Vodafone Group holding 45 percent ownership. Through its FiOS product, Verizon provides fiber-optic delivery of internet, television, and digital voice. Other major operations include IP networks, applications, and professional services for business.

In 2008, Verizon stated its goal to surpass AT&T as the U. S. market leader in wireless voice and data communications in the United States. It is aggressively pushing fiber-optic deployments to combat industry-wide access-line losses. Verizon has over 91 million customers and 220, 000 employees. Verizon reported a $97 billion operating revenue and $6. 5 billion net income as of Dec. 31, 2008.

Balance Sheet – unusual items

AT&T:

At Dec. 31, 2008, AT&T reported a current ratio of 0. 53, and a long-term assets / long-term liabilities ratio of 1. 92. This mismatching indicates that too much short-term financing has been used to acquire long-term assets. AT&T may have problems meeting its short-term obligations without additional refinancing. If additional financing cannot be obtained, a lack of asset liquidity poses a bankruptcy risk.

At Dec. 31, 2008, AT&T reported goodwill at $71. 8 billion, accounting for about 27% of their total reported assets. This stems from AT&T’s aggressive acquisition strategy. The high amount poses a great asset impairment risk. Only losses, not gains, can be recorded for goodwill. If the acquired entities lose value, as judged by an annual impairment test, the loss of recorded assets and corresponding write-offs against stockholders’ equity can be substantial.

Verizon:

At Dec. 31, 2008, Verizon reported wireless licenses valued at $62. 0 billion. These are indefinite-lived intangible asset which account for 30. 6% of Verizon’s total assets. Wireless licenses are extremely important for a

telecommunications company, but placing such large valuation on an intangible is a serious risk. Estimating fair value is very subjective, and any significant write-offs (as judged by a periodic impairment test) could threaten stockholders' confidence.

At Dec. 31, 2008, Verizon reported cash and cash equivalents of $9. 8 billion. Having such a large amount of cash and cash equivalents (investments with a maturity of 90 days or less) is good for liquidity. However, a significant portion of this $9. 8 billion could be converted to less-liquid, higher-interest investments that mature within a year, or even long-term investments. Having so much cash-on-hand is a problem because it is not being invested to return additional value to the business.

Income Statement – unusual items

AT&T:

At Dec. 31, 2008, AT&T reported basic earnings-per-share of $2. 17. During the same period, their nearest market competitor, Verizon, reported $2. 26 basic earnings-per-share. To the common stockholder, this is one of the most important factors to attract and maintain investment. Unless AT&T can achieve higher earnings-per-share, investors will be more likely to invest in their competitors, posing a threat to AT&T's future growth.

At Dec. 31, 2008, AT&T recorded a net other income (expense) of -$589 million (versus +$615 million in 2007). A closer look at Note 4 to the financial statements reveals that this is entirely attributable to " Consolidation and Elimination" expenses. Reorganization due to acquisition and restructuring has been a significant part of AT&T's market-growth strategy, but they must take care not to incur excessive expenses for the

sake of growth. That could lead to an overall loss of competitiveness and lack of stockholders' confidence.

Verizon:

At Dec. 31, 2008, Verizon recorded a net income of $6. 4 billion. Their nearest market competitor, AT&T, posted a net income of $12. 9 billion. In terms of absolute numbers, this gives Verizon less power in the market and also serves as an indication to investors that Verizon might not be managing its finances well enough. Income is essential to future value creation and expansion, so Verizon should strive to improve operational efficiency and attain an income that's more aligned with (or better than) its competitor.

At Dec. 31, 2008, Verizon recorded a net profit margin (ratio of net income to revenues) of only . 066, up from their 2007 profit margin of . 059, but still lower than their 2006 profit margin of . 070. In general, Verizon's profit margin seems low compared to other U. S. telecommunications corporations (especially AT&T), a sign of management's inability to generate strong returns. This weak financial performance should raise concerns for shareholders and financers, and it poses a survival risk to Verizon.

Cash Flow Statement – unusual items

AT&T:

In 2008, AT&T issued $9. 5 billion in dividends to stockholders (which has been increasing gradually since 2004). Consistent dividends are good to attract sustained stockholders' confidence and investment, but a dividend payout of $9. 5 billion is unusually high. By paying out too many excess funds to stockholders, AT&T may be missing out on more lucrative investment opportunities that would generate better returns.

In 2008, AT&T reported $5. 6 billion in accounts payable and accrued liabilities. This amount, due to AT&T's suppliers or banks, must be paid off within 12-months in order to avoid default. This significantly high amount is a constraint against AT&T's working capital. If the company is not able to fully pay off the debt in time, its future operations could be hindered.

Verizon:

In 2008, Verizon reported net $15. 9 billion in acquisitions of licenses, investments, and businesses. Such a substantial investment introduces a high level of business risk. If Verizon's investments do not demonstrate profitability, not only will significant funds have gone to waste, but more doubt will be cast on the corporation's future investing decisions by investors and financers.

In 2008, Verizon accumulated net cash inflows from financing activities of $13. 6 billion. In particular, $21. 6 billion were proceeds from long-term borrowing, while there was a repayment of only $4. 1 billion in long-term borrowing and capital lease obligations. It seems that Verizon is using this leverage to achieve their investing activities discussed previously. Such aggressive financing this fiscal year can put heavy constraints on Verizon's ability to acquire additional financing in future years. Verizon is in a precarious position where, if they cannot repay the financing in a timely manner, they enter a high risk of declining into bankruptcy.

Notes to Financial Statements – unusual items

AT&T:

At Dec. 31, 2008, AT&T reported that $14. 1 billion of its outstanding debt would mature within one year, compared to just $6. 9 billion in the previous

year (see Note 8). This current debt introduces a liquidity problem, since AT&T must be able to generate enough cash in the next year to repay its financers. This is a significant business risk for AT&T; if it is unable to cover its debts in time, its future financing options will be limited and its business operations could be in jeopardy.

As of Jan. 1, 2007, AT&T indicated a loss of $123 million in goodwill related to the " settlement of IRS audit" in its wireless segment (see Note 6). Excess goodwill is already a problem because a high risk of asset impairment is introduced, but devaluation due to an IRS audit raises serious concerns about management's judgment for proper accounting. Investors are cautious about missteps such as this, and a recurring incident could further unsettle their confidence in AT&T.

Verizon:

On Jan. 9, 2009 (beyond the reporting date of the financial statements), Verizon's wireless segment closed the acquisition of Alltel Corporation, paying $5. 9 billion for its equity, but also acquiring $22. 2 billion of its debt obligations (see Note 2). Acquiring such a massive debt puts Verizon at a significant financing risk. The notes reveal that Verizon has relied on credit to immediately cover the acquisition cost and debt prepayments, with $2. 5 billion debt that remains outstanding. Verizon faces potential insolvency – in other words, a high risk of adequate repayment and future refinancing.

At Dec. 31, 2008, Verizon reported obligations for all defined benefit pension plans at $29. 4 billion (see Note 15). The future collection of this large liability poses a financial risk to Verizon, should they not be suitably

prepared to cover the costs. Along with Verizon's already large debt obligations, this is a noteworthy threat to the company's viability.

Balance Sheet – differences

At Dec. 31, 2008, AT&T had a debt-to-equity ratio of 1. 75 (total liabilities / total equity) and Verizon had a debt-to-equity ratio of 3. 85. AT&T and Verizon hold similar levels of total liabilities ($169 and $161 billion, respectively), but AT&T has a great deal more stockholders' equity ($96. 3 versus $41. 7 billion, respectively). AT&T's much larger stockholder interest provides increased financial flexibility and an ability to service its debt, in comparison to Verizon which should be more cautious in its debt accumulation, at risk of being unable to generate enough cash to satisfy its debt obligations. AT&T's lower debt-to-equity ratio may boost stockholders' confidence since their investments are better protected in the event of business decline. On the other hand, AT&T's lower debt-to-equity ratio may signify that it is not taking advantage of enough financial leverage to generate increased profits.

At Dec. 31, 2008, AT&T lists " Customer Lists and Relationships" as a long-term asset valued at net $10. 6 billion. Verizon does not such an item listed on their balance sheet, but Note 4 to the financial statements reveals that customer lists and relationships are a net $820 million component of " Other Intangible Assets". This item is a limited-life intangible asset, and is subject to amortization accumulation. The relatively similar size of each company's customer base suggests that these valuations shouldn't be so drastically different. Estimating fair value of customer lists and relationships is very subjective, based on how each company judges the ability to generate

returns. AT&T’s high valuation compared to Verizon leads to higher annual write-offs of the asset. Stockholders’ confidence could be shaken by too high write-offs arising from higher valuations, so Verizon’s more conservative valuation may be safer in the long-term.

Income Statement – differences

As of 2008, AT&T’s income statements divide “ operating revenues” into five segments: wireless service, voice, data, directory, and other. Verizon’s income statement only specifies a catch-all “ operating revenues” item, but Note 17 to the financial statements identifies two segments: domestic wireless and wireline. Both companies’ wireless segments are equivalent in scope. Verizon’s wireline segment is the equivalent of AT&T’s voice & data segments combined. Notably, AT&T has a more diversified business portfolio, including its directory services which include the publishing of print directories, directory advertising, internet-based advertising, and local search; and the other segment which includes information services, payphone, and corporate operations. The presentation of AT&T’s income statement emphasizes their diversity of operations in comparison to Verizon. This shows two different approaches to business diversification. For Verizon, if one of its two segments were to fail, the financial impact would be catastrophic. For AT&T, the failure of a single segment would be less severe on the company as a whole.

Verizon lists “ minority interest” as a distinct item under operating income with a recorded expense of $6. 16 billion. AT&T does not list a distinct item, but Note 4 to its financial statements indicate that $256 million of minority interest expense is part of its “ other income (expense)” item. Minority

interest expense refers to the share of profit belonging to minority shareholders. In this case, Vodafone owns a 45% interest in Verizon Wireless and receives that share of the generated income. For Verizon, this is a very large amount of income that it could be collecting for itself, if it was to take full control of its wireless subsidiary. If Verizon recognized the full income of its wireless subsidiary, its overall net income would be more competitive with AT&T. Also, by giving Vodafone such a large stake in its wireless subsidiary, there is the potential for a future takeover.

Cash Flow Statement – differences

In 2008, Verizon recorded $13. 6 billion in net cash provided by financing activities, while AT&T recorded $4. 7 billion in net cash used in financing activities. That is, Verizon acquired net debt in its financing activities, while AT&T was able to pay back more financing that it acquired. Because of this, AT&T shows more financial solvency than Verizon, as its ability to repay previous financing activities boosts shareholder confidence and enhances its record as a reliable borrowing partner for future financing. Verizon's big borrowing introduces significant business risks and a potential for bankruptcy if their operations don't return considerable income. On the other hand, Verizon's aggressive financing activities may prove beneficial if it uses the finances to successfully grow its market-share, which would be a threat to AT&T.

In 2008, Verizon recorded $1. 4 billion of purchase of common stock for treasury, while AT&T recorded $6. 1 billion of the same. The goal of these treasury stock repurchases is to increase the value of the shares held by stockholders. Both AT&T and Verizon have repurchased shares over the past

5 years, with AT&T averaging $4. 3 billion in repurchases per year versus Verizon’s $1. 3 billion per year. AT&T’s consistently larger repurchasing may signify that it views its shares as undervalued, or that it wants to improve its reported earnings-per-share. As noted earlier, AT&T’s 2008 earnings-per-share were $0. 09 lower than Verizon’s, so this might be a legitimate strategy to attract future stockholder investment. However, the consistent treasury stock repurchases may be a sign that AT&T is struggling to obtain legitimate interest from investors, so they are instead just acquiring their own shares to inflate the stock’s value.

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