

AT&T Rallies as Windstream Shows Blueprint for Paring Taxes

By Crayton Harrison and Caitlin McCabe

July 29 (Bloomberg) -- AT&T Inc. and Verizon Communications Inc. led a rally in phone stocks after Windstream Holdings Inc. announced plans for a spinoff that provides a blueprint companies could use to reduce their tax bills.

Windstream plans to turn its copper and fiber networks, along with other assets, into a publicly traded real estate investment trust, or REIT, which doesn't have to pay federal income taxes. The deal will let Windstream reduce its debt and free up cash to invest in faster broadband speeds, the Little Rock, Arkansas-based company said today.

Windstream said it already has Internal Revenue Service approval for the deal, sending its shares up 12 percent to \$11.83, a two-year high. AT&T climbed 2.6 percent and Verizon gained 0.8 percent. If state regulators and the Securities and Exchange Commission approve the transaction, it could open the door for the other phone carriers to consider similar deals.

"Management teams will surely look closely at emulating Windstream because the tax savings are potentially so significant," said Craig Moffett, an analyst at MoffettNathanson LLC, in a note. "For a company like AT&T, where free cash flow has been under pressure and management has been willing to push hard to save on taxes, the appeal must surely be great."

Cable companies, which have their own network assets, also rose on the news. Cablevision Systems Corp. climbed 2.3 percent, Comcast Corp. increased 0.5 percent and Time Warner Cable Inc. rose 0.6 percent.

Cutting Taxes

REIT conversions are one way companies have found to squeeze out more profit by reducing corporate tax rates. REITs don't pay federal income taxes with the understanding that they distribute at least 90 percent of taxable earnings to shareholders as dividends. Other companies such as Medtronic Inc. and AbbVie Inc. are seeking to use inversions -- shifting their legal address to another country -- to reduce taxes.

Since Democrats in Congress are busy pushing for tax-law changes to fight inversions, they're not as likely to focus on REIT spinoffs, said Robert Willens, an independent corporate tax consultant.

AT&T, Verizon, Comcast and Cablevision could use transactions like Windstream's to reduce tax payments by as much as \$12 billion a year, depending on their tax structures -- unless lawmakers push back against the idea, said Moffett, the analyst.

REIT Pushback?

"While we would rate the odds of Congress enacting comprehensive tax reform to be low, we would rate the odds of Congress enacting piecemeal legislation in response to a behemoth like AT&T or Verizon or Comcast moving their network assets into a REIT much higher," Moffett said.

While wireless tower companies such as American Tower Corp. have converted their assets into a REIT, it hasn't been tried with infrastructure like Windstream's.

"This is -- I mean, it's so new," David Barden, an analyst at Bank of America Corp.'s Merrill Lynch unit, told Windstream executives on a conference call today. "The whole market's trying to understand this. I mean, are cable companies going to be doing this? Are telecom companies going to be doing this?"

Shares of other small phone carriers rallied. CenturyLink Inc. climbed 5.8 percent to \$39.90. Frontier Communications Corp. surged 14 percent to \$6.79.

"CenturyLink has reviewed restructuring options similar to Windstream's announcement, but has made no decisions at this time," the company said in a statement.

IRS Pause

Luke Szymczak, a Frontier spokesman, didn't return an e-mail request for comment. Emily Edmonds, an AT&T spokeswoman, and Bob Varettoni, a Verizon spokesman, declined to comment.

Windstream got approval from the IRS following a pause at the agency on ruling on such requests. The IRS resumed evaluating the eligibility of assets converting to REITs in November after spending months studying whether nontraditional real estate businesses should qualify.

"The biggest hurdle in this process is getting the private letter ruling from the IRS, and we've got that," said David Avery, a spokesman for Windstream. The deal doesn't need the consent of the Federal Communications Commission, Avery said.

More Acquisitions?

Windstream's tax-free separation will cut debt by about \$3.2 billion and will help produce about \$115 million a year more in free cash flow to invest in broadband, said the company, which has 3.3 million phone lines. The new REIT will be able to acquire other network assets to grow, Windstream Chief Financial Officer Tony Thomas, who will be chief executive officer of the new company, said on the conference call.

The assets in Windstream's REIT plan are similar to fiber and copper networks owned by phone companies around the country.

"There's nothing unique here that others could not replicate," said Kenny Gunderman, executive vice president at Stephens Inc., Windstream's financial adviser for the transaction along with Bank of America Corp.'s Merrill Lynch unit.

Unlike other companies that have converted assets into a REIT, Windstream may be considered a public utility, which would affect the way regulators view its tax benefits, said Phil Owens, vice president at Green Street Advisors, a real estate research firm in Newport Beach, California, that has counseled companies like Equinix on REIT conversions.

'Widely Available'

"People are asking the question if these tax benefits should be passed on to the end user -- you and I when we pay our phone or cable bill -- versus going to the corporation," he said. "That question has yet to be answered. It could be meaningful in this case."

JPMorgan Chase & Co. also advised Windstream on financing with Merrill Lynch. Skadden, Arps, Slate, Meagher & Flom LLP provided legal counsel.

By getting IRS approval, Windstream is dispelling concerns that assets that perform active functions might not qualify for a REIT, said Willens, the tax consultant.

"The message is that the technique is now widely available to any company that has real estate," he said. "This could include McDonald's, J.C. Penney, utility companies, cable companies."

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