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At&t Inc (T) Earnings Report: Q3 2015 Conference Call Transcript

The following At&t Inc conference call took place on October 22, 2015, 04:30 PM ET. This is a transcript of that earnings call:

Company Participants

- Mike Viola; AT&T Inc. ; SVP of IR
- John Stephens; AT&T Inc. ; Senior EVP & CFO

Other Participants

- Amir Rozwadowski; Barclays Capital ; Analyst
- John Hodulik; UBS ; Analyst
- Mike McCormack; Jefferies & Co. ; Analyst
- Phil Cusick; JPMorgan ; Analyst
- Simon Flannery; Morgan Stanley ; Analyst
- Brett Feldman; Goldman Sachs ; Analyst
- David Barden; BofA Merrill Lynch ; Analyst
- Jeff Kvaal; Nomura Securities ; Analyst
- Michael Rollins; Citigroup ; Analyst
- James Ratcliffe; Buckingham Research ; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Ladies and gentlemen, thank you for standing by and welcome to the AT&T third-quarter 2015 earnings call. (Operator Instructions). I will now turn the conference over to Senior Vice President Investor Relations, Mike Viola. Please go ahead, sir.

Mike Viola (SVP of IR):

Okay. Thank you Kathy. Good afternoon, everyone, and welcome to our third-quarter conference call. Thank you for joining us today. With me on the call is John Stephens, AT&T's Chief Financial Officer. John is going to provide an update with perspective on the quarter and then we will follow that with a Q&A session.

Let me remind you that our earnings material is available on the Investor Relations page of AT&T's website and that is AT&T.com/investors.relations. The first slide I have got I need to call your attention to the Safe Harbor statement. Before we begin, as you guys know, it says that there could be some comments today that might be forward-looking and as such they are subject to risks and uncertainties. Our results may differ materially and additional information is available on the Investor Relations page of AT&T's website.

With that I will turn the call over to AT&T's Chief Financial Officer, John Stephens, to discuss our financial and operational highlights.

John Stephens (Senior EVP & CFO):

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Thanks, Mike, and hello, everyone. Thank you for joining us today and for your interest in AT&T . Before we discuss the quarter, I'd like to take a moment and do a quick reset of what we have put in place at AT&T . With the close of our DTV acquisition we became a unique US competitor. We are the first scaled communications and video provider to offer customers fully integrated nationwide products. Our focus is on profitable growth and we believe that we have in place the products and the platforms that will enable our success.

First, you are probably familiar with our new operating segments Business Solutions, Entertainment & Internet Services, Consumer Mobility and International. These segments are built on a series of investments that have set the stage for a new kind of company. Our network investment for the last three years is unprecedented. At a time when customers value and need connectivity more than ever our integrated high-speed wireless and wireline IP networks are in place, ready to meet the growing data demand.

We invested in a deep spectrum position. When you combine the spectrum we bought in the AWS auction along with the WCS spectrum we already own we have 40 megahertz of spectrum in the pipeline that we can use to meet growing customer demand, plus we have added our spectrum from Leap. This provides an efficient way to meet the increasing demand for mobile data. We are also investing in next-generation software defined networks. We plan to virtualize and control more than 75% of our network by 2020 using cloud infrastructure and SDN.

Behind all of this is our focus on profitability. Our improving margins are due in large part to our ability to reduce costs and manage our customer base including letting our customers manage the smartphone handset cycle. Project Agile savings are coming through. Automation and digital first have reduced customer call volumes by an average of 2 million calls a month. Simplified offers help as well, so do the simple blocking and tackling efforts of expense controls, getting it right the first time and working capital efficiencies.

We also are being smarter in growing revenues. We have exited some low-margin businesses such as global hubbing. We have seen increasing capital efficiencies not just with lower trailing operating expense, but also driving lower unit cost as we continue to invest in our world-class networks. In effect we are doing more for less and our expected cost synergies from DIRECTV give us even more runway to reduce costs.

We are uniquely positioned as a company. No other company has the assets and capabilities in place that we do. We are confident that our investments have positioned us with a sustainable and efficient long-term leadership position. With that as background let me cover our consolidated financial summary which is on slide 4.

Let me begin by reminding you that third-quarter results include DIRECTV operations since our acquisition as of July 25. These results exclude the first 24 days of DIRECTV operations in July. Our financial results this quarter provide further support that our strategy is on target. Consolidated revenues, margins and adjusted earnings all delivered solid growth in the quarter and our cash flows were exceptionally strong.

In the third quarter our adjusted EPS was $0.74, that is up nearly 14% over last year's third quarter. This includes adjustments for mostly non-cash Cricket network decommissioning and DIRECTV merger-related costs. The strong growth comes even with earnings pressure from our Mexico wireless operations.

Consolidated revenues grew to $39.1 billion, that is up nearly 19% year-over-year mostly due to our acquisition of DIRECTV . But we grew revenues even if you exclude DIRECTV . And again, this number does not include the first 24 days of DIRECTV revenue as we are reporting under GAAP accounting. If you add

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those revenues to our GAAP number, consolidated revenues for the quarter would have been more than $41.2 billion.

Besides DIRECTV we also had growth from solid gains in our Business Solutions segment, including strategic business services and data, and strong IP data revenue growth in our Entertainment & Internet services segment.

We also had another strong quarter generating cash. Cash from operating activities for the quarter totaled almost $11 billion, up more than 20% over last year's third quarter, and free cash flow was $5.5 billion. That brought our free cash flow dividend payout ratio to 57% for the year. And when you take a look at the last two quarters you can see that we are delivering the financial results that we expected when we started to transform our business.

Combine the second and third quarters and you will see adjusted EPS up more than 12%, $20 billion of cash from operations and $10 billion of free cash flow and record mobility EBITDA service margins in each quarter. Those are the kind of financial metrics we are shooting for and we firmly believe we are positioned to keep that rolling.

Now let's take a look at our operational highlights starting with Business Solutions on slide 5. Our Business Solutions segment includes both wireless and wireline results from our business customers. Mobility is the way business gets done these days and going to market with a total connectivity solution plays to the strengths of our Company. We can see the benefits of this approach in this quarter.

Business wireless and strategic services revenue growth more than offset declines in legacy wireline products. Wireless revenue growth was driven by gains in both wireless service and equipment revenue. Margins were an even better story. Our focus on profitable revenue growth and cutting costs from the business drove a nearly 300 basis point year-over-year improvement in EBITDA margins.

Breaking this segment down further, we saw a revenue growth in three of our four customer categories enterprise, small business and the public sector. Our business wireline revenues were down due to pressure from legacy services, but we continue to see growth stabilization in our wireline data revenues. Total data revenues grew for the fourth consecutive quarter and now comprise nearly 60% of wireline business revenues.

Growth in our most advanced data products is outpacing declines in legacy data services. Strategic business services revenue grew by more than 12% year-over-year and, when you adjust for foreign exchange, growth was even stronger coming in at more than 15%.

We also have improving year-over-year wireline small business trends the last few quarters and that continued in the third quarter. Plus when you include Mobility Solutions we actually grew small business revenues. This gives you a better idea of how our Business Solutions team is competing and winning.

Mobility is just one advantage we bring to the business market. We continue to drive fiber deeper into our wireline network. We have deployed fiber to 950,000 new business customer locations. As you can see in our business results, we are just beginning to tap this growth opportunity.

Our move to software defined network architecture is now not only allowing us to add compelling new services such as NetBond and Network On Demand, but it is also helping us reduce cycle times and move to a lower cost capital and operation structure.

Network On Demand has been met with strong customer response. The product allows customers to adjust network bandwidth as needed in real time. Today it is available in more than 170 cities driving improvement in cycle times and we have already signed more than 275 customer deals. Business

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Solutions focus is making the Network On Demand, the office mobile and the cloud highly secure. That is how we are running our business and we are excited by the results.

Now let me talk about our Entertainment & Internet Solutions results on slide 6. This is basically our former consumer wireline business and the DIRECTV US operations. Even though we had DIRECTV only for part of the quarter, the results reflect the growing revenue and increased profitability that we expect to receive. Reported revenue almost doubled year-over-year, but even more dramatic was the improvement in margins.

Our EBITDA margins came in at more than 22%. That is up more than 800 basis points year-over-year. Essentially we have converted a quality video business with limited scale into an industry leader earning solid margins through our DIRECTV acquisition. And we think there is plenty of room to improve even more with the expected cost synergies from the DTV deal.

During the past few weeks we have reached a multiyear agreement with Viacom for U-verse and DIRECTV subscribers and we believe we are on a path for the best content pricing going forward. Our approach is to develop a win-win situation for both us and the content providers and encourage them to look at our wireless and broadband assets to widen their distributions. Early results have been promising.

We are also seeing some early success on the revenue synergies. For example, we are selling DIRECTV in virtually all our 2,200 Company-owned stores. The next step is launching certified dealers and online as well as ramping up sales in our call centers. It is starting to make an impact. DIRECTV net adds picked up shortly after the deal closed and were solid throughout the rest of the quarter. That drove 26,000 satellite net adds post deal close. We now have more than 25 million video subscribers in the US.

It is important that we do this right coming out of the gate. We have been holding back much of our cross-selling promotions as we train service reps and technicians for a premium single service experience so we will see the benefit of those strategies impact future quarters. As expected, U-verse video subscribers declined in the quarters. Net adds dropped with fewer promotions and shifting our focus to the lower content cost DIRECTV platform.

We added 192,000 IP broadband customers in the quarter as migrations from our DSL base continued to slow. U-verse video losses also put some pressure on broadband numbers due to our high attachment rates. But we are confident we can work through this as our single service experience for broadband and satellite is rolled out.

As we said, it is early in our integration of DIRECTV . We don't even have a full quarter of results, yet our integration efforts are on or ahead of target and early results indicate this deal will prove to be everything we thought it would be and more.

Now let's move to our Mobility results on slide 7. AT&T Mobility operations are now divided between the Business Solutions and the customer wireless segment. That information is in the investor briefing and stat profile. For comparison purposes the Company is also providing supplemental information for its total domestic wireless operations.

Let's start first with the total domestic wireless operation's financials. We have a compelling value proposition, great network, superior customer service and fair pricing. All this sometimes gets lost in the competitive noise. Our focus is to provide the best customer experience while increasing profitability and not just chase customer counts.

Our third-quarter results drive that point home. We had our highest ever wireless service EBITDA margins at 49.4%. Our consumer mobility business helped drive that with service margins of more than 50%. AT&T Next sales are a big part of that success, but we also have been very aggressive in taking costs

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out of the business and increasing efficiencies in our Cricket operations.

Total wireless revenues were flat year-over-year. Lower year-over-year smartphone upgrade volumes impacted equipment revenues and Mobile Share Value plans did the same to service revenues. As expected, with most of the conversion to Mobile Share Value plans behind us, we saw increasing stability with our service revenues which were essentially flat with second-quarter levels.

We also continue to see steady growth of AT&T Next and mobile share value plans. About two-thirds of our postpaid smartphone base is on no subsidy pricing with more than 40% on Next. That gives us substantial opportunity to continue to grow equipment revenue as these customers upgrade their smartphones. For the quarter, nearly 80% of the smartphone sales were on Next or BYOD.

We also continue to see growing phone only ARPU plus Next which increased by nearly 5% year-over-year. We also turned in another strong net add quarter as postpaid tablets, Cricket and the connected car drove our highest net adds in nearly five years. Those details are on slide 8.

Total net adds came in at 2.5 million as we continue to see the impact of our Cricket acquisition and connected car strategy. The Company added 289,000 postpaid subscribers with about 620,000 tablets and computing devices. We also had a record 1.6 million connected device net adds; most of these were connected cars where we added about 1 million.

Or perhaps the biggest story in the quarter had to be our continued strength in premium prepaid. This has been a remarkable turnaround story for us. We added 466,000 prepaid voice subscribers in the quarter after losing subscribers in the year ago third quarter. These subscriber gains came from both Cricket and our GoPhone products. We also completed our Cricket network conversion in the quarter.

We are seeing Cricket deliver great ARPUs, in fact the ARPU from Cricket smartphone net adds is nearly $10 more than our postpaid feature phone ARPU losses. We continue to grow our branded smartphone base. We added 1 million in the quarter. Branded voice subscribers were also positive in the quarter. Total churn was down year-over-year thanks to lower prepaid churn even with shutting down the Cricket network.

Postpaid churn for the quarter was up year-over-year as we focus on higher value subscribers. However, year-to-date postpaid churn is running at 1.06%, just slightly higher than last year's best ever full-year churn of 1.04%.

Here is another way to look at churn. We are adding premium prepaid subscribers whose ARPU is higher and subsidy costs are lower than postpaid feature phone subscribers who have the highest postpaid churn. And our success in the prepaid market is resulting in improvement in total churn.

Cricket gives us a quality prepaid offering for the more value conscious customer. Same great network, quality customer service and the flexibility prepaid delivers with subscriber acquisition costs that are much lower than our postpaid voice. Now let's look at our international operations. That information is on slide 9.

Our international segment provides wireless services to Mexico and satellite entertainment services in Latin America. Let's start with Mexico. We are taking the first steps in our investment cycle in Mexico and pushing hard to replicate the same great 4G LTE network experience there that we have in the United States.

So far we are making great progress. By the end of the third quarter we have already covered about 29 million people with our 4G LTE network. And as of today we now cover more than 30 million. This puts us on plan to reach 40 million by the end of the year and provide a high-quality platform to sell on.

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Mexico's financials reflect our network investment and the work being done to bring Iusacell and Nextel's operations together. This is the heavy lifting of the wireless business. We have done it before and we are confident we can do it again successfully.

We are also confident that we will grow market share. We have a great leadership team in place and a solid plan not only to deploy the highest quality network, but deliver a superb customer experience as well. It is a great opportunity and the potential synergies of a 400 million POP North American calling area make it even better than we first imagined.

Our Latin American DIRECTV operations are showing solid growth on a local currency basis, but foreign exchange rates, including our decision to adopt the SIMADI rate in Venezuela, are pressuring our results. Revenues, ARPUs and margins are all pressured by FX and subscriber results are being hampered by challenging economies in the region.

But importantly, our Latin American businesses have cash flows that allow us the opportunity to better position our operations. We will continue to work through these headwinds and work on operational efficiencies in Latin America.

Now let's move to consolidated margins on slide 10. Our focus on profitable growth is clearly seen in our consolidated margins. Adjusted consolidated operating margins came in at 20.3% in the quarter. This was a dramatic improvement over the year ago third quarter and adjusted EBITDA margin was nearly 200 basis points higher than a year ago. There were several reasons for this improvement.

First, the DIRECTV acquisition increased the profitability of our pay-TV business, but just as important was our focused sales approach in wireless and U-verse video. Project Agile savings also are coming in ahead of plans. Our simplified offers and increased efforts to take care of customers on the first call has produced results.

Call volumes in our mobility centers continue to drop down an average of 2 million calls a month when compared to the year ago third quarter. We also have been highly effective with our cost optimization efforts that has helped drive down cost for access and in our supply chain.

We are also keeping an eye on the force by minimizing outsourcing expenses. Overall force has been managed through voluntary retirement programs, normal attritions and normal reductions in operations. Trailing operating expenses from capital investments also are down year-over-year. We also have been highly efficient with our capital spending and unit costs are decreasing, essentially doing more for less.

All of this adds up and DIRECTV gives us an opportunity to expand margins. We have our target to get to $2.5 billion or more in savings. We already are realizing some of that in our content and supplier relationships. We really like our momentum here and we are confident we can continue to expand margins and cut costs even with pressure from our international operations. We also believe healthy cash flows are fundamental to our success. Let's look at slide 11 for those details.

We continue to execute and deliver strong cash flows. In fact, we are increasing our free cash flow guidance for the year. In the third quarter cash from operations totaled $10.8 billion, that is our best cash generation in 12 quarters, and we generated $26.7 billion in cash year to date. Capital expenditures totaled $5.3 billion, about the same as last year's third quarter. Free cash flow was $5.5 billion and $12.8 billion year to date.

In terms of uses of cash, dividends totaled $2.4 billion which gives us a dividend payout ratio of 44% for the quarter and 57% for the full-year. Our net debt to adjusted EBITDA ratio was 2.28 which was better than our original expectations.

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Our focus is on maintaining a strong balance sheet. We paid down more than $5 billion in debt early and we still have more than $6 billion of cash on hand. These strong cash flows are a fundamental part of our business. This gives us the financial strength to invest in our business, reduce debt and return substantial value to our shareholders.

Now let me close with a quick summary and updated guidance on slide 12 before we get to your questions. First, let's address guidance. We are increasing our full-year EPS outlook to the $2.68 to $2.74 range. We also now expect free cash flow to be in the $15 billion range or better this year. All other full-year guidance is reaffirmed. Our focus on profitability is a big reason we are able to do this. In the quarter we saw growing revenues, expanding margins and double-digit adjusted EPS growth.

But just as important was our ability to generate cash from our business. Cash from operations was strong and free cash flow gave us excellent dividend coverage. We are seeing positive signs in our largest segment, Business Solutions. Customers appreciate our integrated solutions approach and are migrating to our newest software defined network services. We also saw our highest ever wireless service EBITDA margins with an incredible turnaround story in prepaid unfolding.

And we closed the DTV acquisition in the third quarter and the integration process is on target and positioned to exceed expectations. This is an exciting time for us. We believe we have the pieces in place to redefine our business and our industry. With that, I will turn it back to Mike so we can get back to your questions.

Mike Viola (SVP of IR):

Okay, Kathy, so we are ready for the Q&A. And if you can queue up the first question we would appreciate it.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions). Amir Rozwadowski, Barclays.

Amir Rozwadowski (Analyst - Barclays Capital):

Thank you very much. Wanted to touch upon the commentary around cash flow, John, if I may. If we take a look at your raised outlook for the year, it does seem as though there is a little bit of a tempering in the cash generation in the fourth quarter. I would love to hear about what your spending priorities are and, more specifically, how to think about the longer-term cash generation capabilities of the joint entity.

John Stephens (Senior EVP & CFO):

A couple of things. One, as you know, there is always some seasonality in the fourth quarter with the holiday sales in our wireless business with the purchase of handsets and so forth. So there is always some seasonality. As you would find also with our wireline, particularly our large business segment. Also we generally have larger tax payments at the end of the year than we do early on.

So those are the things that are impacting us but I would tell you if you do kind of a year-over-year comparison to where we are at and what we are projecting with regard to the $15 billion range or better, I think you will see that we are continuing to have really good cash flows throughout the rest of this year.

Secondly, with regard to future years, we would stand by what we have said earlier. That is that we expect free cash flow to provide us with a dividend payout ratio that is in the 70s. We are not moving away from that, we are not shying away from that at all and expect that to continue to be the case.

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We are certainly proud of these results and glad that we exceeded what we had promised. But we are going to be careful and prudent in predicting our results as we go forward. But we are real excited about where we stand and the future cash generation of this business.

Amir Rozwadowski (Analyst - Barclays Capital):

Thank you very much. Then if I may a follow-up here in thinking about the joint entity moving forward, particularly when it comes to the potential opportunities with positioning the Company and targeting sort of your end markets. At your analyst update you had highlighted that there are areas for potential cross synergies -- revenue synergies and opportunities.

Specifically I am thinking about the 15 million DIRECTV households that don't have access to AT&T wireless services. I was wondering if you could give us some color in terms of how you plan on going after that opportunity and how we should think about leveraging the breadth of the full portfolio to target sort of areas where you may have one subscriber on one service and not on the other.

John Stephens (Senior EVP & CFO):

Let me take that quickly. First of all, the first revenue synergy that we have really gone after and we've seen good success and quite frankly we are very excited about the results is in the cross-selling of DIRECTV of the satellite product in our company-owned stores. We have about 2,300 company-owned stores and virtually all of them are actively selling DIRECTV now. And some of them have never sold a video product before.

So we had to do some training and some learning. But what we found as we came through the quarter, we were able to sell more and more out of those stores and we got very optimistic about it and it gives us optimism for the fourth quarter. So that sales effort and that first line of synergy, if you will, from revenue opportunities from the retail distribution chain is working and we are real optimistic about it.

The second one, with regard to cross selling DIRECTV in the wireless customers, we needed to go through a process of making sure our privacy policies and a bunch of other administrative policies were lined up consistently so customers had a seamless experience and an easy experience.

We have done all that and I think we have now got in place one of our call centers to service those customers on an integrated basis and we are moving forward with starting to sell that. Based on the really great news we saw from the retail chain we are really optimistic about seeing those sales results unfold in the fourth quarter and next year.

The last thing is our service technicians have been installing broadband for us or U-verse for us but they haven't been installing DIRECTV . So we have been putting them through a training program and we are expecting that to roll out -- the first set of technicians to roll out after fully trained on installing satellite in the home in probably November or so, the early part of November, such that we will then be able to sell a single truck roll installation for broadband and video.

We are very excited about that, it will be a measured approach, we are going to have to -- we don't have everybody trained on the first day, but we are excited about what that will bring and think that will bring some not only good performance in the fourth quarter, but quite frankly really look forward to that kind of performance, positive performance and impact next year. So that is kind of the way we are thinking about some of those things.

Amir Rozwadowski (Analyst - Barclays Capital):

Thank you very much for taking the questions.

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Operator:

John Hodulik, UBS.

John Hodulik (Analyst - UBS):

Great. If we could focus a little bit on the guidance. First of all, John, is it possible for you to give us sort of a where we are on a year-to-date basis in terms of the $2.68 to $2.74? And then maybe what's driving the change in terms of -- is it just wireless margins? They were definitely ahead of where we were. Or are you realizing synergies faster or are there any other moving parts? That would be great. Thanks.

John Stephens (Senior EVP & CFO):

So we are at the $2.09 mark today, and so that was ahead of our prior plans. As you know the $0.74, I will say it was ahead of our most recent plans. That has really been driven by cost efficiency and it is driven by savings across the board, whether it is lower number of calls into the call centers, whether it is the really top-notch performance of our digital first initiatives, whether it is the streamlining of our installation process through what we call Project Halo or high automation low overhead process, whether it is the software defined networks.

All of those things, whether it is just blocking and tackling, taking calls into the call center and getting answers right the first time -- all of those things, all of those things are driving cost savings. And we have seen some better performance, as I mentioned, in our Business Solutions.

Our Business Solutions team is really doing well in a tough economy particularly in the enterprise and the public sector space, but really well in the small business space and that gives us optimism. As we mentioned, with wireless you were seeing growth in that area. But we are seeing the acceptance of our Network On Demand, our NetBond, our software defined networks all moving customers in a positive direction.

So, it is all of those things giving us optimism for the fourth quarter. With that being said, certainly wireless and its performance goes without question, that it is helping drive earnings performance.

John Hodulik (Analyst - UBS):

Great. Thanks, John.

Operator:

Mike McCormack, Jefferies.

Mike McCormack (Analyst - Jefferies & Co.):

Thanks. John, maybe just dig a little bit into the churn commentary. Your thoughts on whether or not we are seeing a spike up in involuntary. And then how does that sort of pace out if we look at the feature phone subs, are those the ones I am assuming most at risk there?

And then secondly, just on the ARPU side, I know last quarter you benefited from year-over-year easy comps. I am assuming as we go into the fourth quarter we should sort of restart that trajectory and year-over-year declines getting better?

John Stephens (Senior EVP & CFO):

Let me take them separately, Mike. On the churn first and foremost, yes, the feature phone churn is sitting us and having an impact on us and those are decisions we made not to chase those customers. Can't

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make the math work on not only the pricing for those customers but the impact on our base.

But secondly, we believe that we are picking that up and showing tremendous improvement in the prepaid space with Cricket, so we are seeing total churn come down which I think is really important.

With regard to ARPUs, we did have an easier comparison in the second quarter of 2015 to second quarter of 2014 because of some promotional activities that took place in the second quarter of 2014. But we have seen stabilization in our ARPUs and in our total service revenue, so we feel optimistic about the business going forward.

But once again, we are going to be focused on profitable growth, not just chasing customer counts or specific targets. We are going to really be focused on just getting the most profits out of the business.

Mike McCormack (Analyst - Jefferies & Co.):

John, just a quick follow-up on the churn commentary. Is there anything happening on the involuntary side that you are seeing there?

John Stephens (Senior EVP & CFO):

Mike, I wouldn't turn you to that. We haven't seen a significant change in bad debts I would like to (inaudible) I wouldn't point to that. Our customer base is quite frankly -- we are very lucky to have the quality customer base we have. We are very fortunate.

Mike McCormack (Analyst - Jefferies & Co.):

Great. Thanks, John.

Operator:

Phil Cusick, JPMorgan

Phil Cusick (Analyst - JPMorgan):

Thanks. So first on EPS, should we be thinking for 2016 of the mid-single-digit or better off of the $2.71 midpoint? Or should we be thinking about it a different way given the DTV deal? Thanks.

John Stephens (Senior EVP & CFO):

So we will take it this way, we are not changing our guidance for 2016 going forward. So the mid-single-digit growth rate is still good. I'm not going to refer to -- it is still good even with this adjusted guidance, updated (multiple speakers).

Phil Cusick (Analyst - JPMorgan):

So $2.71 is the right starting point? Thanks. And then on Project Agile, can you give us an update on what sort of the overall cost-cutting level is here and how we should think about that pacing in the next few years?

John Stephens (Senior EVP & CFO):

I would say that we are going to expect it to continue growing over the next few years. What we had said originally was that we were shooting for $3 billion of cost savings. I would suggest to you that we are probably somewhere between the third and half of the way there. And that we plan to at least get there, get to that total target or exceed it. And then I would point to the $2.5 billion of targeted DTV merger synergies.

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And certainly based on what we know now we expect to see us get there or exceed those. So those would be the two points. I would hope that we could exceed the Project Agile targets based on the progress we have made so far, these efforts do take time and investment. We have been spending that time and investment over the last couple years to get here. We are seeing the results pay off and we are going to keep our focus in this direction, but we would hope to be able to exceed it.

Phil Cusick (Analyst - JPMorgan):

Thanks, John.

Operator:

Simon Flannery, Morgan Stanley .

Simon Flannery (Analyst - Morgan Stanley):

Thank you very much. Good evening. John, can you talk a little bit about the video momentum and you sort of went through some of the channel changes here. You had -- on a net basis you did have subscriber losses. But I think you said before that you are hoping to grow your video subscribers over time.

So, perhaps you could just take us through the quarter. And you showed some good gross adds on the DTV side. What is going on there with churn and when do you expect to return to positive video adds? Thanks.

John Stephens (Senior EVP & CFO):

Good question. I think we had a slide on this with a chart that can kind of tell you what was going on. Prior to the deal there was some real pressure in the video -- satellite video area. There was some -- performance was less than it had been last year. And then as you see -- coming out after the merger and after we started rolling out sales in the stores you can see that we really picked up the trend and we expect that to continue.

Secondly, with the rollout this quarter of the, if you will, one truck roll or single service experience where we can install TV and broadband at the same time, we not only expect the satellite TV to pick up, but we also expect the broadband -- IP broadband to pick up because people buy those things together.

And so, we are hopeful that we are going to see -- we will be able to show you some improvements and trend improvements continuing off of the third quarter in the fourth quarter. Won't make any predictions about specific levels, but we are optimistic in what we have seen so far. We think the trends are headed in the right direction. And we think the slide that we put together that shows that differentiation between 2014 and 2015 will give you a good insight into that.

Simon Flannery (Analyst - Morgan Stanley):

And the U-verse decline, is that sort of run rate or is that all the gross adds shifting to DIRECTV or is that a churn issue as well?

John Stephens (Senior EVP & CFO):

U-verse a couple of things. One, certainly the lower cost platform has been our first choice for net adds. Two, because of our focus on profitability we really got away from promotional pricing and those customers who were cost sensitive that just had a propensity to churn -- when you first put those steps in place we saw a little bit of a higher churn in the second quarter, we are seeing a little bit higher in the third quarter because of that disciplined approach.

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But I would tell you I think we still have a solid, very good, very high quality customer base in U-verse and we are certainly looking to continue to serve those customers with the best products and services. So I think we are focused on lowering churn and keeping those customers quite satisfied.

Operator:

Brett Feldman, Goldman Sachs .

Brett Feldman (Analyst - Goldman Sachs):

Just a quick point of clarification and then a question. You talk about the fulfillment accounting methodology change in the slide, is that your previous methodology change from August or was there something new?

John Stephens (Senior EVP & CFO):

That is the same change. And if I could before you ask your question let me kind of give you guys some insights on it. On a year-over-year basis in this quarter the fulfillment accounting had about a $0.02 impact. That is the differential between applying it to DIRECTV and U-verse this quarter as opposed to just applying it to the U-verse product last third quarter of 2014.

And so, that did give us some help. Additionally, in this quarter I want to point out we had about $0.01 of help from the CAF funding activity that went on and what we applied for. By the same token we had about $0.01 of hurt or pressure from the Mexico operations that we didn't have last year. And if you look at our income tax expense, except for setting aside anything that we treated otherwise there is about $0.02 of income tax pressure, EPS pressure from income taxes.

So, when you look at the fulfillment accounting and the other kind of unique items that occurred, they kind of balance off with the CAF funding and fulfillment accounting generating about $0.03 of benefits and Mexico and the income taxes generating about $0.03 of pressure.

So, we treated those as going -- because they are going to be going forward, because they are going to be continuing we wanted to make sure I pointed that out. But that being said, Brett, I interrupted you before you got to ask your question. I apologize.

Brett Feldman (Analyst - Goldman Sachs):

No, that was helpful. The question is we have a lot of new data points and disclosures that we have fun modeling tonight. But one of the things we see here is we have video ARPU and we have IP broadband ARPU trends in your new entertainment segment.

And I guess as you think about your strategy going forward, your bundling strategy I mean do you have any guidance you can offer us to think about the right way to think of the trajectory of those two key items because they are so critical to the revenue outlook for that segment?

John Stephens (Senior EVP & CFO):

Yes, I think we are going to be looking to continuing to protect and improve on the trends that we have seen, so growing those ARPUs. But likewise with these assets that we have in place I would suggest to you that our ability to capture the market -- we are in a very good position to capture the market.

Now that we have video where we had broadband before without any video and now that we have broadband where DIRECTV had video but didn't have broadband before. [So I want] to suggest to you that we are going to look for profitable growth and focus on that, but we are excited, we are positive about the fact that in some of those cases we have some growing ARPUs.

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Brett Feldman (Analyst - Goldman Sachs):

So just to be clear it sounds like you are really excited about the opportunity to add more customer, more revenue-generating units, that is going to be a big piece of how we think about shaping revenue growth through that segment?

John Stephens (Senior EVP & CFO):

We are very much -- we're very excited about the ability to add customers -- absolutely. I don't want to suggest that we are not going to focus on profitable customers. Certainly are, but we are very excited about the opportunities.

I will go back to the cross-selling opportunities, I will go back to -- we have got high, high quality video products and we have a high-quality wireless network and a high-quality broadband capabilities and they have capacity in all of them. And so, that is a great way to expand your profits and by expanding the customers on those investments that you have already completed.

Brett Feldman (Analyst - Goldman Sachs):

Great. Thank you for the color.

Operator:

David Barden, Bank of America .

David Barden (Analyst - BofA Merrill Lynch):

Thanks for taking the questions. I guess two if I could. Just first, John, a little bit following up on that question just in terms of kind of looking at the new way that AT&T is presenting itself to the marketplace, should we be looking at modeling the wireless business separately in consumers business as giving us two very unique pictures of two very unique businesses?

Or is this really just AT&T wireless the way it has always been run and we really should be just thinking about dividing it between the two pieces? That would be the first one.

And the second one is on CapEx, there are so many now new parts to the business. Could you kind of give us how CapEx is now being allocated between the Latin America, the Mexico, the domestic business units and how we should think about all those different pieces trending? Thanks.

John Stephens (Senior EVP & CFO):

So a couple things. One, David, for investor and [analystees] we provided total wireless and then provided the consumer wireless the ability to get to the business wireless. We have tried to be very upfront with regard to our financial presentation, so hopefully we have been successful at that, but we tried to do that to make sure you had that information.

Two, I would suggest to you that as you look at it the margins and the EBITDA and profitability -- they are certainly different but they are not materially different, they don't significantly skew one way or the other. So I would make that observation for you.

With regard to how you model, I'll leave that to you guys modeling. I can tell you the way we focused on it is what the business relationships were selling and what our consumer relationships were selling and that is how we focused on it. But I think the information is there to do it either way. And I think it is going to be a matter of what you are most comfortable with.

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As we go forward and we see the platform we built with connected devices start showing more growth even than it already has it will be beneficial for everyone to have this split.

With regard to CapEx, I won't get into specific dollars on a quarterly basis, but I will give you these insights. On DTV Latin America, our Latin America properties, I would expect that they will be generally self-sufficient, that the cash flows that they generate will be self-sufficient to cover their CapEx needs.

I would suggest to you if we customer growth opportunities we will be prudent about that and make sure that we don't miss out on a good customer. But generally speaking it is going to be self-sufficient from a cash perspective.

On Mexico I would suggest to you that the $3 billion we announced some months ago with regard to the build out is still a good number. We started on that process. I won't tell you that every POP, every 4G LTE POP cost the same amount to create. Some of the networks were more advanced and so some of the earlier achievement may be at a more efficient cost -- unit cost.

But I would suggest to you the $3 billion is still a good number. And then we will continue to invest, albeit at a slower rate, because we built the platforms out. We will continue to invest in fiber and wireless capacity and in success-based capital for our satellite video product much in the same way you would have seen us in the past taking into account the fact that the ramp up in CapEx for VIP is now behind us.

We are 950,000 business customer locations passed with fiber, we committed to 1 million, we will get to the 1 million but that is the only piece that isn't done.

David Barden (Analyst - BofA Merrill Lynch):

Got it. Thanks, John.

Operator:

Jeff Kvaal, Nomura.

Jeff Kvaal (Analyst - Nomura Securities):

Yes. Thank you all very much. I was hoping that we could spend a bit more time talking about churn. It seems as though there are some natural feature issues that are there on the postpaid side anyway, prepaid is faring quite well. Could you help us understand if we should be expecting more of that across the industry? Is this an AT&T specific item that will stick with us for a few quarters or how we should see that?

And then secondly, I am wondering on the DIRECTV synergies what might be the first opportunity that you would have to update us on whether you are on or ahead of plan for that $2.5 billion? Thank you.

John Stephens (Senior EVP & CFO):

Sure. On the feature phone phenomenon I would tell you that, yes, our base of feature phones continues to get smaller. So over time we will lessen the impact this has on our churn.

Secondly, Jeff, I would leave it to you guys to talk about or to decide whether others in the industry are taking this approach. It appears to us from where we see customers moving around that some of the other carriers are not taking the same approach and they are focused more on customer counts than they are necessarily on the profitability of the customers. But I think you would be the better judge of figuring that out. And I say that based on the offers I see that we are dealing with and the noise in the market.

On the $2.5 billion I think first and foremost you will see in our results, but with regard to updating you, I

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think we will continue to update you on the process like we have done today where we've talked about how the retail stores are generating sales exceeding our expectations, how the single truck roll is going to start rolling out in November, those kinds of things.

And I think you will see us also update you like we did with the Viacom announcement where we basically said that we are going to get best in the industry pricing for our platform. And so that would imply that we are getting to or meeting or exceeding our synergy targets.

With regard to specifically reporting on the $2.5 billion number, I don't expect to be doing that in the rest of this year or early next year because we are still in the midst of really getting it done and were more focused on getting it done than we are on reporting out on what it is.

Jeff Kvaal (Analyst - Nomura Securities):

Okay. Thank you very much and we will try and sort it out. You aren't making it easy for me in my first quarter but I will do my best.

John Stephens (Senior EVP & CFO):

I'm sorry about that, Jeff. I'm sorry about that.

Jeff Kvaal (Analyst - Nomura Securities):

I'm delighted to be here.

John Stephens (Senior EVP & CFO):

We really did put the financial statements together a way to try to make it as easy as possible to see. So we will do our best.

Operator:

Michael Rollins , Citi.

Michael Rollins (Analyst - Citigroup):

Thanks for taking the questions. Two if I could. First, going back to the 2016 guidance where you described improving free cash flow, I was curious if that relates back to the free cash flow guidance in August or does that now refer to the updated free cash flow guidance for 2015?

John Stephens (Senior EVP & CFO):

That applied to the free cash flow guidance of $13 billion or better.

Michael Rollins (Analyst - Citigroup):

Okay. And then secondly, can you just talk about in wireless how you are thinking about device installments versus the possibility of using leases as an alternative financing mechanism for customers and how you see the environment evolving competitively for your mobile smartphone customers? Thank you.

John Stephens (Senior EVP & CFO):

Good question. First and foremost, with regard to installment plan versus a lease, we certainly have the financial capability wherewithal to manage either one, to do either one and we are open to it. But quite frankly, right now our customers seem quite pleased with the installment program.

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And simply put they seem to like it because at the end of their term they own the phone. The phones have continued use and functionality for them and they continue to use that. To some extent we are seeing a side of that from this continued use of bring your own device activities at our Company where people are bringing in devices that they already own and hooking them up to our network.

But from a Company perspective it is more of a decision and Ralph de la Vega and Glenn Lurie and the team follow it really closely. It is more about what the customers want and if we see that the customers are going to want that program we will certainly consider -- we certainly have the capability to do it.

But right now we believe that the customer satisfaction comes from that ability to own the phone at the end of that agreed to term and they feel real comfortable about that. And quite frankly the difference in price I don't think is measurable from the lease to the -- depending upon what situation you have. But when you get down to the real cost of it, it seems like it has worked out well for us by doing the installment plan.

Michael Rollins (Analyst - Citigroup):

Thanks very much.

Operator:

James Ratcliffe, Buckingham Research.

James Ratcliffe (Analyst - Buckingham Research):

Thanks for taking the question. Two if I could. First on wireless and just following up, broadly do you see value in actually selling the phone to the customer? In other words, does it matter whether somebody gets their new iPhone from you or gets it from -- orders it from Apple and it sits on their books?

And secondly, on broadband, a couple quarters now where you're overall losing customers. Can you give us a little insight on what the trends are in DSL and particularly where those losses are coming? Are those people in areas where you don't offer U-verse or is it an additional migration over to U-verse in areas where you do offer it? Thanks.

John Stephens (Senior EVP & CFO):

On the value side at customers it is more about being able to provide in the stores a full scope customer experience and take care of all their needs. That is what we are concerned about. From a perspective of the -- if they buy the phone somewhere else and bring it to us we are thrilled with serving them in that way. We don't have the cost of handling the phone or we don't, quite frankly, have the cost of financing the phone either on our installed plan or through a subsidized program. So we are open to it.

Right now under the equipment installment program that Apple has, they sent us a high number of phones through that program and that is fine, we love to serve our customers that way. And if that is how they choose to buy the phone through Apple and Apple finances them, that is something we can definitely work with. It is really more about what does the customer want and how do we make sure we provide choices and services to make it easy for our customers?

With regard to our broadband trends and specifically in DSL, the first comment I would make to you is over the last few years the real trend has been a migration from DSL to IP broadband. And that has been something that we have encouraged ourselves and we are beginning to complete that process or are near completion where the DSL customers we have left is a much lower percentage that have IP broadband capabilities from us. So, we are through that migration process.

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And then secondly, they don't have television in these areas or I should say we didn't have a video offering. These were generally out of the U-verse footprint, but now we do. And now we will be able to provide them a video offering through DIRECTV and we are very pleased with that.

So we are hopeful that now this nationwide video service will help us in improving our overall broadband positioning, but particularly our U-verse broadband footprint where we have the higher speeds, where customers generally buy video and broadband together we now can sell that together. So that is how we are thinking about it, that is how we look to it.

I would tell you I think on the consumer side we are down into the 2 million range on total DSL customers. I think the exact number would be on the stat profile. But I would suggest to you it has changed dramatically over the course of four or five years where it used to be 90% plus of our broadband base and now it is a much lower percentage. So we have gone through that migration, not completely but almost completely.

James Ratcliffe (Analyst - Buckingham Research):

Great, thank you.

John Stephens (Senior EVP & CFO):

With that I want to thank all of you for being on the call today and just give you a few closing comments before we go. The third quarter clearly delivered on our transformation strategy. We saw double-digit growth in our key financial metrics including another outstanding free cash flow quarter. The integration of DIRECTV is also on track. We expect to meet or beat our $2.5 billion cost synergy target and we are just beginning to unleash potential promotional activities to drive bundled sales.

You can see our increased confidence in the guidance update where we raised our adjusted EPS and free cash flow expectations for the year. We believe this is just the beginning. We are positioned as a unique competitor and the first scaled communications and video provider to offer fully integrated nationwide products and we fully expect to increase our momentum as we go forward.

Thanks again for being on the call. On your way home tonight please don't text and drive. Remember, it can wait. And as always, thank you for your interest and AT&T and have a good evening.

Operator:

Thank you. And ladies and gentlemen, that does conclude our conference for today.

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