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AT&T (T) Earnings Report: Q4 2015 Conference Call Transcript

The following AT&T conference call took place on January 26, 2016, 04:30 PM ET. This is a transcript of that earnings call:

Company Participants

- Mike Viola; AT&T; VP of IR
- Randall Stephenson; AT&T; Chairman & CEO
- John Stephens; AT&T; SEVP, CFO

Other Participants

- Mike McCormack; Jefferies; Analyst
- Phil Cusick; JP Morgan; Analyst
- Amir Rozwadowski; Barclays Capital; Analyst
- Brett Feldman; Goldman Sachs; Analyst
- David Barden; BofA Merrill Lynch; Analyst
- James Ratcliffe; Buckingham; Analyst
- Simon Flannery; Morgan Stanley; Analyst
- Frank Louthan; Raymond James; Analyst
- Michael Rollins; Citigroup; Analyst
- Timothy Horan; Oppenheimer; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Ladies and gentlemen, thank you for standing by and welcome to the AT&T fourth-quarter earnings conference call.

(Operator Instructions)

At this time, I would like to turn the conference call over to your host, Senior Vice President of Investor Relations Mr. Mike Viola. Please go ahead.

Mike Viola (VP of IR):

Okay. Thank you, Operator. Good afternoon, everybody. Welcome to our fourth-quarter conference call. It is great to have all of you with us.

Joining me on the call today is Randall Stephenson, AT&T's Chairman and Chief Executive Officer; and John Stephens, AT&T's Chief Financial Officer.

Randall will provide some opening comments and then he will close with 2016 guidance. John will cover our results and we will follow all of that up with the Q&A session.

Let me remind you our earnings material is available on the investor relations page of the AT&T website at ATT.com/investor.relations.

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Before we begin, I need to call your attention to our Safe Harbor statement. You have seen this before, but it says that some of our comments today may be forward looking and, as such, they are subject to risks and uncertainties. Results may differ materially and additional information is available on the investor relations page of AT&T's website.

So with that, I will turn the call over to AT&T's Chief Executive Officer, Randall Stephenson.

Randall Stephenson (Chairman & CEO):

Okay, thanks, Mike, and good afternoon, everybody.

Before John steps you through the results, I want to take just a couple of minutes and just reiterate the strategy we are pursuing. That is to be the premier integrated communications company in the world, and obviously that's a strategy that we are pursuing in every single market segment and it is from our largest multinational customers to the most price-sensitive consumer.

And when you look at 2015, it was an eventful year where we put together a lot of the pieces that were required to fulfill this objective. Primarily, we closed on the DIRECTV acquisition and we secured a very deep spectrum footprint in the government auction, and that's giving us the network capacity for our TV Everywhere plans, and we acquired two Mexican wireless companies with extensive spectrum holdings and distribution and this gives us access to one of the very best emerging-market economies in the world.

Now we financed the DIRECTV and spectrum purchases at very attractive rates, and we did all of this, put it together, and exited 2015 with a very strong balance sheet, and our dividend coverage has returned to a level that is very consistent with our historic norm.

As you look at our strategy, the core is getting the basic connectivity element right because if you want to be an integrated solution provider, it requires more than anything else world-class, high-speed, secure connectivity, and it can't be just wireless connectivity or broadband to the home or the business, but all connectivity -- wireless, broadband, satellite, VPN, and it all has to be integrated.

So, for example, TV Everywhere. DIRECTV is really accelerating our introduction of next-generation TV, and the DIRECTV content agreements, combined with our networks, is proving to be a very powerful combination. So we can now deliver the best entertainment packages over traditional linear TV or streamed over the Internet to essentially any mobile device.

A couple of weeks ago, we launched a nationwide solution that combines any of our TV entertainment packages with unlimited mobile data so our customers can now stream their video without incurring overage charges. And this is only our first move. You're going to see the offers and the customer experience continue to get better and better as we move through 2016.

We also launched a number of integrated solutions for businesses and I think the best example of this is our Network On Demand service, which lets customers dial their bandwidth up or down literally on demand. And our NetBond service is also having a lot of success and I think this is a beautiful example of an integrated solution. That gives the Company the capability to secure access -- to securely access information from a mobile device over a VPN into virtually any major cloud provider, and that includes Amazon , Microsoft , IBM, or Salesforce.com .

The common thread to all of this is providing our customers with a seamless integrated experience. And again, the core to making all this happen is the network and our LTE network now covers 355 million people and businesses in North America and we expect to hit the 385 million mark by the end of this year.

We are continuing to build out our GigaPower footprint, and we can now deliver speeds up to 1 gig to over 1 million customer locations in 20 markets and we have announced plans to enter an additional 36

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markets. We also continue to expand our fiber network to more businesses, so we are really feeling good about our networks and we believe we do have the most comprehensive capabilities now in the industry.

But to compete in today's market, the solutions do have to be global solutions because at the end of the day our customers are global, and that global focus is why we are the leader in serving multinational businesses. In fact, we connect 3.5 million businesses -- that includes nearly all the Fortune 1000, and we do it in almost 200 countries and territories. We have extended our wireless network into Mexico now, and as you're going to see in a few minutes, our growth in Mexico is exceeding all of our expectations.

And also in 2015, we built on our global leadership position in the Internet of Things, and our IoT solutions are not US solutions, they are global solutions. We invested very early in this space and it is paying off. We now have over 26 million devices connected to our network.

We are also a leader in connected cars. We added 1 million of them in the fourth quarter, and recently, we completed a deal with Ford that we believe is going to connect at least 10 million cars over the next five years.

And finally, we are investing aggressively in a network architecture that is going to give us a competitive advantage in cost. We are driving the industry to software-defined networks and I have seen few opportunities over my career to drive down the cost to deliver service like this. We're also on track to deliver at least $2.5 billion in annual DIRECTV synergies by 2018.

And we continue to invest in spectrum. We began last year by investing $18 billion in the auction to significantly deepen our spectrum footprint, and as a result, we now have 40 megahertz of [final] spectrum to deploy over the next few years to support TV Everywhere. But just as important is the impact that such a deep spectrum footprint will have on our cost to build and operate our networks.

So as we look out over the next few years, we are convinced the software defined networks, combined with the DIRECTV synergies and our deep spectrum position, are going to give us an industry-leading cost structure, and our objective is really straightforward. We want to move the most traffic at the lowest cost per bit.

Today, we think we are a Company with no obvious peer. We have a nationwide TV and wireless footprint. Our IP broadband footprint reaches nearly 60 million customer locations. We have end-to-end capabilities in enterprise, world-class distribution, and a globally respected brand, and while all these transformative moves were taking place, we executed pretty well in 2015.

If you look at slide 5, as you see, adjusted EPS growth was solid. Our cash flows were way up. Margins continued to expand and consolidated revenue growth was on track. We ended 2015 with 137 million mobility subscribers, 45 million video subscribers, 13 million IP broadband customers, and an LTE network that is covering 355 million people, and we're seeing nice growth across all of our key product categories.

In the fourth quarter, we had really solid net adds in wireless, satellite, video, and IP broadband.

So to wrap it up, the strategy is working. We have the critical capabilities we need to execute the strategy, and I'm going to hand it over to John now. Then I will come back later to give a full-year outlook for what we see in 2016. So with that, John?

John Stephens (SEVP, CFO):

Thanks, Randall, and hello, everyone. It's great to have you on the call.

Let's start by taking a look at the quarter and our financial summary on slide 6. We finished the year strong. We had double-digit growth in consolidated revenues, adjusted earnings, and free cash flow. At

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the same time, we continue to see margin expansion in every segment of our domestic business.

In the fourth quarter, reported EPS was $0.65 and adjusted EPS was $0.63. That is up more than 12% over last year's fourth quarter. This included adjustments for merger and integration related costs and the annual mark to market of our benefit plans. This strong growth comes even with earnings pressure from our Mexico wireless operations and some deferral of recognition of video revenue.

Consolidated revenues grew to $42.1 billion. That's up more than 22% year over year, mostly due to our acquisition of DIRECTV . That growth comes even with lower equipment sales, as customers chose to hold onto their smartphones for a longer period of time.

During the quarter, the Company aligned DIRECTV's revenue recognition for new customer promotional offers to AT&T's practices. The Company will now recognize revenues from customers reflecting the amounts billed over time. Recognition of expenses will not change. The fourth-quarter impact of this change resulted in lower booked revenues by about $300 million and it had a corresponding impact on income, margin, and a $0.03 impact on EPS as well.

Cash flows continue to be a great story. Free cash flow was more than $3 billion in the quarter and nearly $16 billion for the full year. That brought our free cash flow dividend coverage to about 64% for the year.

Let's take a closer look at our operational highlights, starting with business solutions on slide 7. The biggest news here in our business solutions segment was our dramatic margin improvement. EBITDA margins improved 360 basis points year over year as cost efficiencies far outpaced equipment revenue declines. Equipment sales were down year over year as we sold fewer handsets and less wireline CPE to our business customers. But higher-margin service revenues were essentially flat on a constant-currency basis, with growing strategic services and wireless services largely offsetting legacy wireline declines.

We continue to see stabilization in our wireline data revenues. Total data revenues now comprise nearly 60% of wireline business revenues. Growth in our most advanced data products is keeping pace with declines in legacy data services. Strategic services revenues grew by more than 10% year over year, and when you adjust for foreign-exchange pressure, growth was even stronger, coming in at more than 12%.

We serve the total connectivity needs of our customers, and more and more that means mobility. Mobility in cloud solutions are changing the way business gets done and AT&T is delivering this to customers. We are connecting people, cars, homes, cities, devices, machines, and businesses to the Internet and each other.

We have established ourselves as the world leader in IoT. We signed more than 300 new Internet of Things business agreements in 2015 alone, and recently announced new connected car agreements with Ford and BMW build on our industry leadership in that category. And our new smart cities and connected health initiatives demonstrate how connected devices can help cut costs, grow revenues, boost efficiency, and satisfy customers' needs.

Let's now move to our entertainment group results on slide 8. This is our first full quarter reporting with DIRECTV and the results reflect the growing revenue and increased profitability that we expected to receive from combining these operations. Reported revenues for the quarter more than doubled year over year, mostly due to the DTV acquisition, but our U-verse revenues also showed solid growth.

We also saw exceptional margin expansion, which points directly to the benefits of the acquisition. Our EBITDA margins came in at more than 22%. That is up more than 800 basis points year over year.

We've shifted our marketing focus to driving satellite net adds, and you can see that in our subscriber results. Satellite net adds were 214,000, with our total video net adds for the quarter down just slightly.

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We have been really pleased with our growing flow share with DIRECTV . Year-over-year gross adds have been up every month since the deal was closed, thanks in large part to our wider distribution. And we are seeing an increase in satellite customers in our wireline footprint bundling broadband with their video service. Sales of satellite and IP broadband to new customers are up 60% from the end of the third quarter this year. That helped drive an increase of more than 190,000 total IP broadband subscribers in the fourth quarter.

It is still early, but we see a lot more opportunity to use video to drive sales and lower churn for all of our services. Our new unlimited wireless data for combined wireless and TV customers has been very popular since we introduced it two weeks ago. We have already had more than 0.5 million wireless subscribers sign up for the unlimited data plan, and TV net adds are going strong as well.

And we expect to launch a variety of new video entertainment packages this year. These offers definitely add some sizzle to our bundling offers, but the real impact is to build a strong relationship with our customer base. Our goal is a TV Everywhere experience with broad viewer choice both inside and outside the home that is simple and easy for our customers to use.

AT&T is already a leading provider of online video. Our DIRECTV app already allows live video streaming of more than 100 different networks, and by the end of the first quarter, we expect to have nearly all of the top 25 cable networks. We have already seen about a 50% increase in the number of customers using the DTV app since the second quarter of the year. We are driving an OTT capability with our video services, one that provides great choices at a fair price and, as importantly, is also a win-win for the content providers and our integrated offerings.

Now, let's move to our US mobility results on slide 9. As a reminder, AT&T's domestic mobility operations are now divided between the business solutions and consumer wireless segments. For comparison purposes, we are providing supplemental information for our total US wireless operations here.

During the fourth quarter, total net adds came in strong, with 2.2 million new subscribers and with gains in every customer category. That's the third consecutive quarter where net adds have exceeded 2 million.

Almost 1 million of those net adds were branded, which includes both postpaid and prepaid, driving positive phone additions in the quarter. We're putting a lot more focus on branded customers, and with good reason.

Cricket has energized the prepaid space for us. We added more prepaid subscribers than any other carrier in 2015. In fact, we added more subscribers than the rest of the industry combined, and Cricket churn is coming in at industry-leading levels. This helped drive an increase of 213,000 branded phone subscribers in the quarter. Compare that with our postpaid pressure with about 250,000 phones, the vast majority of which were higher churning feature phones with average ARPUs at about $35. All the while, three-quarters of our Cricket gross adds in the fourth quarter were on rate plans that were $50 or higher.

This points to the overall strength of our business and our ability to operate an efficient, smart business in a competitive, mature market.

We also continued to grow our high-value smartphone base, adding about 1 million branded smartphone subs during the quarter. At the same time, we had another strong churn quarter. Total churn was down year over year, once again thanks to our great networks, our quality offers, and our top-notch customer service.

Postpaid churn came in at 1.18% for the quarter, an improvement from the year-ago quarter, and full-year postpaid churn was 1.09%, one of our best years ever. That's an impressive performance at a time when

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we focused on higher-value subscribers in a heavily competitive market.

And I need to add a point about the Cricket churn. We have seen improving churn throughout the year, even as we shut down the legacy CDMA network and moved subscribers to our 4G LTE network. Fourth-quarter Cricket churn was the best yet, coming in at 3.8%, or a 170-point improvement over last year's fourth quarter and about half when you look at the comparable Leap fourth quarter from two years ago.

Cricket has become a powerful part of our wireless story, and we are very pleased in how it is performing and we expect it to do even more in 2016.

Wireless margins and ARPU are on slide 10. Our relentless efforts to drive efficiency and move our smartphone customer base to the no-subsidy model once again drove record wireless EBITDA margins. You can see this clearly in our operating expenses. While equipment revenues were down more than $700 million, mostly due to the lower upgrade volumes, total cash operating costs were down $1.8 billion, thanks to our sharp focus on cost management and efficiency. That helped increase EBITDA by nearly $900 million in the quarter and drive our best ever fourth-quarter EBITDA service margin of 43.2%.

We also had our best ever full-year service EBITDA margin, coming in at 46.7%. By the way, if you exclude regulatory and insurance fees in service revenues, as some of our competitors do, our full-year number is about 50%.

Total wireless revenue was impacted by lower smartphone sales. Service revenues continue to stabilize. Equipment revenues also were impacted by an increasing number of bring-your-own-device subscribers. We had about 700,000 in the quarter. That includes those who purchased new smartphones through vendor leasing programs or vendor installment programs. BYOD sales are our lowest-cost subscribers and we're happy to have them. They value our quality network coverage and reliability, as well our great selection of rate plans.

Phone-only plus Next ARPU continue to grow at a steady pace, up 4.6% even with a growing number of BYOD subs. The number of smartphone customers on no-device subsidy plans continues to expand. More than two-thirds of smartphone subscribers or nearly 70% are on no-subsidy plans, with about 46% of that smartphone base on AT&T Next plans.

Now, let's look at our international operations. That information is on slide 11. The wireless team in Mexico is really getting after it these days. First, we blew through our year-end 4G LTE deployment target by reaching 44 million POPs. That puts us well on our way to our next benchmark of reaching 75 million POPs by the end of the year and it brings our North American LTE coverage to 355 million people, which is more than any other carrier.

We also launched our rebranding to the AT&T name in several areas, beginning in markets where we've deployed LTE. That includes Guadalajara and Monterrey, with Mexico City slated for April.

And we continue to expand our distribution network. We have added 1,000 new store locations since we acquired these properties earlier in the year.

All of this helped drive strong subscriber growth through the quarter, or nearly 600,000 total net adds, with gains in both prepaid and postpaid.

Mexico financials continue to reflect our operational investment and strong subscriber growth. We expect comparable results in the first half of the year and the investment cycle to continue through 2016.

In Latin America, our DIRECTV operations continue to show solid growth on a local currency basis, but foreign-exchange rates continue to pressure our results. Revenues, ARPUs, and margins are all pressured by FX that are being hampered by challenging economies across Latin America.

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Subscriber pressures in Brazil impacted net adds, but even with all this, we generated modest positive cash flow from these operations in the quarter. All in all, we feel very confident that we will be able to create value with this business and with these assets. We are more integrated with the day-to-day operations and we have sold local management teams that are adding stability in a very challenging economic environment.

Now, let's move to the consolidated margins on slide 12. Consolidated margins reflect the overall strength of our business. Adjusted consolidating income margin came in at 16.8% in the quarter. This was a 230 basis-point improvement over the year-ago fourth quarter. And adjusted EBITDA margin was 160 basis points higher than a year ago.

Strong fourth-quarter results helped drive a 130 basis-point improvement in the full-year adjusted operating income margin. That's a tremendous accomplishment for a Company with $146 billion in revenue.

There was some reasons for this improvement -- strong margin expansion in our entertainment group and business solutions, and our focused sales approach and efficiencies in wireless drove strong consumer mobility margin gains as well. We will continue our laser focus on cost reductions. We have driven savings through greater efficiencies, productivity gains, and expense savings.

[Project Vantage] continues to build momentum, as do our digital first initiatives. We are seeing cycle-time reduction and lower call volumes. Software defined networking will radically reshape not only our cost, but also the flexibility of our network deployment. Our margin momentum continues to be strong. Per capita, we continue to expand domestic margins and to cut costs to offset pressure while we are in the investment cycle in Mexico.

Cash flows were outstanding in 2015. Let's take a look on slide 13. We proved our ability to generate cash in 2015 and our ability to have strong free cash flow, even with strong capital investment. In the fourth quarter, cash from operations were more than $9 billion, and we have generated more than $35 billion in operating cash flow in 2015.

Capital investment totaled $6.8 billion for the quarter. This includes about $700 million that we spent in Mexico where we received equipment and are putting it into service in the normal course, but we had financing terms from our vendors that don't require us to pay for it until the end of 2016 or a little bit later.

For the year, we made capital investments of nearly $21 billion. Free cash flow was $3.1 billion. For the full year, it was nearly $16 billion, coming in higher than our increased guidance.

We also continue to tap the securitization market to manage working capital with Next. We received about $900 million in the fourth quarter.

When you combine this with the foregone payments from prior securitizations, the net impact is about $100 million of pressure on cash flow. So, cash flow in and of itself was very strong from operations.

In terms of uses of cash, dividends totaled $2.9 billion for the quarter and about $10 billion for the year, which gave us a payout ratio of 64%. Net debt to adjusted EBITDA ratio was 2.31. We ended the year with $5.5 billion in cash and short-term investments. We are proud of our ability to generate cash. This gives us the financial strength to invest in our business, reduce debt, and return substantial value to our shareholders.

Now, I will turn it back to Randall to provide our 2016 outlook.

Randall Stephenson (Chairman & CEO):

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Okay, thank you, John.

Last summer, we provided a long-term guidance after we closed the DIRECTV deal, and, look, it really hasn't changed. We are tracking almost exactly on what we told you. And so when you look at 2016, what you can expect is double-digit consolidated revenue growth, adjusted EPS growth in the mid single-digit range or better, stable consolidated margins, with a solid business plan to improve in each segment, even while we are investing in Mexico.

Capital spending will be in the $22 billion range, with our focus on cost efficiencies and SDN creating a downward bias to that forecast, and we expect our free cash flow dividend payout ratio to be in the 70s, with a goal of growing free cash flow this year.

So that kind of wraps it up. With that, John and Mike and I are glad to stand for questions.

Operator, we will turn it back to you.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Mike McCormack, Jefferies.

Mike McCormack (Analyst - Jefferies):

John, maybe just a comment on the service revenue in overall wireless? It should be lapping the big Mobile Share Value push last year. Just trying to get a sense for the trajectory on the year-over-year declines. It looks like it continues to get better. I am assuming we should expect that throughout the year.

And then secondly, in the entertainment segment, I guess looking at sequential margins versus year over year, it looks flatter sequentially, but there was the impact of the revenue recognition change. I'm just trying to get a sense for what we should be thinking about with margin trajectory there, maybe particularly as you go in there and get more wireless rights for content and maybe where those wireless right content costs flow through the model.

John Stephens (SEVP, CFO):

Thanks, Mike. Let me give you a couple of insights there, first into the service revenues in wireless.

We have to wait and see what 2016 brings, but we are expecting it to improve throughout the year, the year-over-year trends. We continue to see a little optimism in what we are seeing from the customers in demand, but we will -- so we expect to see improvement throughout the year in that service revenue.

On the entertainment margins, let me -- the first point I would like to make is the $300 million revenue deferral did impact margins in this quarter. The margins would have been close to a couple hundred basis points higher if we would have that recognition. That's the first point I would want to make to you.

The second point, what we will see is we will see the merger synergy savings starting to show up in margins in 2016, and specifically most of the $1.5 billion worth of run rate savings we expect to get to by the end of the year we will start seeing coming through the entertainment group. As we go through the year, we will see what happens with other competing interests, but clearly those items are leaving us with the expectation that we will have improving margins in the entertainment group.

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Mike McCormack (Analyst - Jefferies):

John, just as you progress on getting more and more mobile rights for content, how should we think about where those incremental costs for the rights should flow through? Is it entertainment or is it on the mobility side?

John Stephens (SEVP, CFO):

I would expect they would flow through in the entertainment group.

Mike McCormack (Analyst - Jefferies):

Okay, great. Thanks, guys.

Operator:

Phil Cusick, JPMorgan .

Phil Cusick (Analyst - JP Morgan):

Two things, first to follow up on Mike's question. Can you just remind us, John, what the deferral is and will that impact revenue any further or is this the most you'll need to defer?

And then second, Randall, since 2009 you have been known as a bit of an economic savant. Can you give us an idea of what you're seeing from your customers in the US, both consumer and enterprise, and do you see any signs of economic weakness? Thanks.

John Stephens (SEVP, CFO):

Phil, on the revenue deferral, this has to do with one of our major contracts and one of our customers signed a two-year contract and so we -- previously, DTV had recognized it equally over each month of the contract. We recognize it as we bill it, so we just came to a consistency that brought us to the AT&T methodology. So that $300 million is not in any way, shape, or form lost revenue. It is just deferred. It doesn't change our customer contracts, won't change our cash collection. It is just a deferral.

And additionally, we didn't defer any expenses. We continue to recognize any out-of-pocket expenses with regard to that in the same way we had done before.

Phil Cusick (Analyst - JP Morgan):

And that's mostly only going to impact 4Q, right?

John Stephens (SEVP, CFO):

There will be some further impacts throughout next year, but by the end of next year, we will get into the situation where the originating piece and the reversing piece of this will be offsetting, but that will take us through next year.

Phil Cusick (Analyst - JP Morgan):

Got it.

Randall Stephenson (Chairman & CEO):

And Phil, this is Randall, your economic savant. I have never been called that before.

Phil Cusick (Analyst - JP Morgan):

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Exactly.

Randall Stephenson (Chairman & CEO):

So it won't surprise you what we are seeing. We are seeing some softness when you look at enterprise business on anybody that has anything that touches the oil and gas industry. All of those companies are a little bit defensive right now, as you might guess.

Also, anybody -- the big exporters, people who are exporting who have exposure to foreign currencies, particularly the strong dollar, we are seeing weakness there.

But I will tell you we are netted out. Our revenues held their own on the business side because we are taking share, and NetBond and Network On Demand, we're having a lot of success in the marketplace, and so we are taking share and holding our own, but we are seeing some softness in those areas.

You know, the consumer continues to spend money. In fact, it was a decent holiday season in light of there was really aggressive competition, but the consumer continued to spend money. I might have anticipated -- in fact, I did anticipate -- a little more robust Christmas season because you are seeing energy prices at lows we haven't seen in a long time, and you didn't see the step-up in consumer spending that you might have expected in third and fourth quarter.

But the consumer did continue to spend.

As we look at 2016, we have built this plan around a 2% GDP growth rate in the US, roughly, and there is a lot of science that goes into that, but you can basically turn around and look at the last few years and see it has been 2%. It is not really hard to forecast it these days. We have been fairly tight in terms of hitting our estimates for the last few years.

What I am concerned about, I will be honest with you, is as you look at 2015, there are a lot of things that went the consumers' way and that went the economy's way, not the least of which are energy prices. But even over the last few years, there has been some benefit from 10 million people being put back to work.

And so as we get to the end of 2015, those benefits that we've seen over the last couple of quarters, you look forward, are you going to see those in the future? Probably not. And so, I made a comment last week that got picked up that we are assuming 2%. If you ask me to handicap is there more downside or upside to that, probably downside. But it is probably within a tight range of 2% is what our estimate is right now, Phil.

Phil Cusick (Analyst - JP Morgan):

Thanks, Randall.

Operator:

Amir Rozwadowski, Barclays.

Amir Rozwadowski (Analyst - Barclays Capital):

The first question I wanted to ask was around your strategy in the mobile arena. As you mentioned, Randall, during the prepared remarks, you have unveiled what I assume is the first of many plans integrating your mobile and video anywhere solutions. How should we think about your approach towards the competitive landscape going forward in terms of your go-to-market strategy?

It does seem as though on a relative basis you probably weren't as promotional as some of your competitors and would love to hear your thoughts as we progress through 2016.

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Randall Stephenson (Chairman & CEO):

You bet, Amir. So we closed DIRECTV on July 24 and immediately put in place some plans that would be -- were the first phase of integration. We dropped the TV capability into our retail stores and have had nice lifts, as you heard John talk about, going through his remarks. And then January, we had -- we did the unlimited data plan for our TV subscribers.

What you should expect is you're just going to continue to see, as we roll through 2016, capabilities and offers that take advantage of putting the two together, and the customer experience is going to continue to get better and you're going to see offers that we think are unique in the marketplace.

I am not going to get very detailed with you right now, Amir, because we're still in the process of getting some of the really critical content deals secured. But things are coming together very nicely and you're going to see a phased rollout over the next few days, and in fact, within the next 45 days, you'll get your first look at what one of these will look like.

And so, stay tuned, but I think it will be an eventful year for the industry as we roll out new and different kind of capabilities, new and different type programming options for the mobile device, and even new ways to think about how you price in a mobile-centric environment. So, actually I am very energized, and the further we get into it and work with our partners on the content side, the more energized I get about it.

Amir Rozwadowski (Analyst - Barclays Capital):

Thank you very much. And then maybe if I can switch gears to the video side, as you mentioned it seems as though you continue to benefit from healthy DIRECTV net adds, but on a net basis if we look at the total video ads, there has been a bit of a holdback on the U-verse side. How should we think about the opportunity in the video arena going forwards, specifically on how to think about the trajectory of your footprint and potential subscriber opportunity there? As the integration has progressed, are you on the verge of rolling out more converged offerings with broadband and video and how should we think about that opportunity set for you folks?

Randall Stephenson (Chairman & CEO):

So, Amir, I tell you right now we're early in the process. The sales channel is just really starting to get their legs underneath them on how to attach satellite and mobility together. This is a new category, and so we are very, very new in this.

And the performance continues to get better and better in the sales channel. Also, keep in mind that we don't even have the installation work for us up to speed on provisioning this, and so we are just getting the installation and workforce up. We just had -- the latest union contract gave us the rights we needed to push this out across our entire footprint.

And so, you're going to see us continue to get better and better there as well.

As you pointed out, the satellite adds were strong in the fourth quarter, but U-verse churn offset that, so we were slightly negative in total. You'll see that relationship get better, and we are doing some things to shore up the U-verse base because we are focused on the satellite product and so, as a result, you are seeing U-verse churn off. We are doing some things to shore that up. It will improve, not the least of which we did some things on pricing to ensure that we can help begin to mitigate the U-verse churn.

The other thing we did, and it is early, but I think we're going to see some not inconsequential impacts from this, is the unlimited offer for all of our TV customers. U-verse customers can now step into an unlimited data offer, and this is, we think, a hugely retentive offer. It is a great value for our customers to

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have this type of offer put in front of them.

So, we think you will see the U-verse churn get better. You'll see the subscriber numbers continue to improve as we move through 2016, and the sales channel improves, the provisioning channel improves, and then some of these offers I talked about, some unique offers that will be mobile-centric offers and some unique content available, we think those are going to continue to add momentum to this as well. So bottom line, we think the subscription numbers get better as we go through the course of the year.

Amir Rozwadowski (Analyst - Barclays Capital):

Thank you very much for taking the questions.

Operator:

Brett Feldman, Goldman Sachs .

Brett Feldman (Analyst - Goldman Sachs):

Thanks for taking the question, and John, just a question on the cash flow outlook that you provided for this year. You obviously gave us some help thinking about the revenue, the EBITDA, and the CapEx piece parts in that calculation. I think you had mentioned some deferred CapEx related to Mexico. I am curious if that is factored into the guidance.

If you can give us any help on how to think about cash taxes with deferred bonus depreciation or extended bonus depreciation and anything else that we need to think about, like pension, that would be very value added. Thanks so much.

John Stephens (SEVP, CFO):

Sure, couple of things. One, with regard to the deferred payments in Mexico, those have been in our plans all along. We continue to work on the cash flow opportunities that we have been doing for a number of years, so those are all in already. That's nothing new here.

Secondly, with regard to bonus depreciation, as we had told the community when we first gave our guidance that we were taking that into consideration, assuming that we would get it passed, but we would meet this guidance even if it didn't get passed. It has gotten passed.

The one point I would make to everyone is that it is now 15 years where bonus depreciation has been in place, and so getting the bonus depreciation extended for five years and getting us that [eternity] is really important, but the creation of benefits from bonus depreciation is now being largely offset by the reversal of prior years' benefits that have been taken by taxpayers, so it is much more of a balancing item there.

With regard to that, the pressures on cash flow do not come from our pension. We had a pension contribution we will make this year, in about $200 million, but that has already been in the plans. That is the only thing that is required. Our pension plan is very well funded, and then we do expect total tax payments to be up this year from a -- on a year-over-year basis.

But as you know from our prior-year filings, our tax payments were rather modest last year, and then, so we would expect those to go up. But all in, we feel pretty comfortable about hitting our guidance and we're certainly working very, very hard to do better on that guidance.

Brett Feldman (Analyst - Goldman Sachs):

Okay, and just to make sure I heard it correctly, and maybe I didn't, but I think you said that this year's

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CapEx did include some of those deferred payments in Mexico, meaning that it will hit your free cash flow next year, even though you have already recognized the CapEx early on your (multiple speakers)

John Stephens (SEVP, CFO):

So, the way we will talk about CapEx is like it was this year that it was $20.7 billion, and we will have about that 15% of the service revenues, which is about -- so it gets to be about $22 billion for this year. That will be our CapEx. The working capital impact of paying for some of last year's purchases this year is in our working capital calculations. I think of it separately from CapEx numbers, but yes, it is already in that guidance and we won't be adjusting the guidance for that.

Brett Feldman (Analyst - Goldman Sachs):

Great, thank you for that color. I appreciate it.

Operator:

David Barden, Bank of America Merrill Lynch.

David Barden (Analyst - BofA Merrill Lynch):

Thanks for taking the questions. Maybe this one is for John or Randall. For the first time in a while, we are looking at some reasonably comfortable headroom on the balance sheet at 2.3 times leverage versus, I think, your historical comfort level limit of 2.5 turns, and for a company of AT&T's size, that is real money.

Obviously, we have the 600 megahertz auction coming up. The New York Post tells us you are buying Time Warner . There is obviously a lot of things that could be on the agenda here including, just sticking to your deleveraging agenda. Could you rank order some of the ways you want to use what headroom appears to be there relative to the deleveraging priorities? Thanks.

John Stephens (SEVP, CFO):

Yes, thanks. With our strong cash flows, we're going to continue to invest in networks, as we have said, keep this quality up and keep these product offerings moving on, and we felt comfortable about doing that within that $22 billion range. We do believe that positions us well.

We do think that includes all our merchant integration activities. We have got a lot of fallow spectrum out there that we've bought over the last few years, so we're in a very good position to be able to operate within those kind of parameters and still provide the highest quality service.

With regard to the cash that is after we have done that investment, we're going to pay our dividends and we're going to continue to be, if you will, loyal and respectful of our shareholders, in accordance with our Board's direction.

Third, we are going to focus on reducing debt levels, but with that, as you do that, you keep your balance sheet strong and keep opportunities available. But that's where we will be focusing.

Randall Stephenson (Chairman & CEO):

Yes, right now I think we have been pretty clear that the next couple of years we want to get our debt levels back down to more normal levels for us. We have spiked them a little bit to get the spectrum bought last year, and then also to do the DIRECTV deal, so we're going to spend the next couple of years working the debt back down before we start talking about different capital allocations in terms of share buyback or anything of any magnitude.

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David Barden (Analyst - BofA Merrill Lynch):

And could we interpret that as being relative to historical comments of being willing to bid, for instance, $9 billion in the 600 megahertz auction? Would those comments, Randall, suggest maybe you're going to take a much more conservative tack as that comes up?

Randall Stephenson (Chairman & CEO):

We will see what the auction brings and how everybody participates, but I haven't been bashful saying if there is an opportunity to get another 2 by 10 at that spectrum, we would pursue it, and so we think we can do that within the guidance John has given here and execute on that.

But we will have to see, David. It is not yet to us really clear what the spectrum footprints are going to look like and whether you can piece together truly a ubiquitous 2 by 10 type footprint, which is really important to us. To be bringing another band of spectrum into our operation, it is going to really important to have a ubiquitous broad footprint.

And so, we will have to look at that, and obviously we're going to have to look at the FirstNet bid that the government has just issued the RFP on. So there are a lot of ways we will evaluate the spectrum scenario, but it is reasonable to assume that we will be active one place or the other.

David Barden (Analyst - BofA Merrill Lynch):

Got it. Thanks, guys.

Operator:

James Ratcliffe, Buckingham Research Group.

James Ratcliffe (Analyst - Buckingham):

Thanks for taking the question, two if I could. First of all, just diving a little more into the DTV integration, any incremental thoughts on sizing what the revenue upside there is? I know it's early, but now that you have, for example, some track record regarding unlimited data and you would be able to share data across the two operations.

And secondly, any incremental thoughts on the status of sponsor data and how you expect to see that roll out over the course of the year? Thanks.

John Stephens (SEVP, CFO):

On the DTV integration, the revenue upside, let me frame it this way. We're pleased with what we have seen so far, specifically the unlimited data and the wireless I mentioned. We have had 500,000 wireless customers sign up for it already, so we are real pleased with it. We think there is great opportunities there.

The timing of it, though, is going to give us reason for some carefulness there, for this reason. For example, Randall mentioned the training of our technicians who do the installs. We are just going through the completion of that now and that's really going to be more of a second half of the year where we see how really effective that is. We have seen a lot more bundling of the satellite with broadband, but we need some more time to make sure that we understand the momentum of that and the progress of that.

Additionally, we are still going through the sales process of training our reps who never sold broadband when they sold satellite before or who sold broadband but never sold satellite before, and, as Randall

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pointed out, the accounts who sold wireless will have to increase all their sales activities whether in stores or in the call centers.

So all of this is going to take some time for us to really get a track record. I will tell you we're optimistic. I am pleased with the initial results, but giving any guidance on the revenue synergies from that perspective is a little premature.

Randall Stephenson (Chairman & CEO):

On your question on sponsor data, James, I think it is important to think about what we have assembled here. And so between DIRECTV and our Otter Media relationship, we think we have the best premium set of content available to anybody anywhere, and we are getting the rights secured to allow us to begin delivering this over whatever platform the customer wishes. If the customer wants it on a tablet or a smartphone or on a TV, we are getting to the place where we can do that.

Now if you think about the most premium set of content, whether it be sports programming, whether it be binged type programming that has stacking rights and look-back capabilities, whether it be movie libraries or whatnot, it is just a very, very robust set of content that we are piecing together here to be delivered.

I think one would just have to assume that sponsored data would be a critical element on how the customer would take advantage of this, and so we haven't developed -- or announced, I should say -- we are doing a lot of work right now on how we come to market. We have not announced any plans, but I think it would be reasonable to assume sponsored data would be a part of how our customers would take advantage of this kind of content library.

James Ratcliffe (Analyst - Buckingham):

Thank you.

Operator:

Simon Flannery, Morgan Stanley .

Simon Flannery (Analyst - Morgan Stanley):

John, perhaps you could give us some sense of what you are including in 2016 guidance for realized synergies and any kind of expectation around what integration costs might be this year.

And then, Randall, following up on that content theme, maybe you can update us on the Otter Media and the joint venture with Chernin and any perspective on whether you want to get deeper into ownership of content more broadly. Thank you.

John Stephens (SEVP, CFO):

So Simon, I would say it this way. By the end of the year, we would expect to be on a run rate of $1.5 billion, which is going to be about $125 million a month. That is how we think about it. That is how we did our plans.

We certainly don't mean to imply we're at that level in January, don't want to convey that. We are not. I don't expect that, but we expect it to grow throughout the year.

We did have a very good first five months of getting costs aligned and addressing a lot of the administrative or headquarter -- some of the easier costs to see start getting out, so we did lower that and we are making good progress on the content. And we are making -- and, quite frankly, are shifting to

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a satellite-based customer basis is helping.

But from your question perspective, I would think of it in that way, that we're going to hit and hopefully exceed the $1.5 billion run rate, which will be $125 million a month by the December time frame, fourth quarter time frame.

With regard to any capital required for those integration costs, that is already included in the $22 billion of capital guidance. And from the expectation of integration costs, while we have some, having given guidance, I would suggest to you this way -- if you think about what makes up our integration savings, our merger savings, content negotiation, staffing, supply chain, the costs to do that are not necessarily significant. It is just a matter of getting it done and doing the business.

So I wouldn't expect those types of merger integration costs to be significant. I will tell you we are still going to have customer-based amortization, trademark tradings amortization, those kinds of normal merger and integration. We're pretty explicit with those in the details we provide in our filings.

Simon Flannery (Analyst - Morgan Stanley):

Thank you.

Randall Stephenson (Chairman & CEO):

On the content side and specifically, yes, about Otter Media, that's going well. We are still early, but as everybody knows, we are partnered with Peter Chernin, who I happen to think is probably the best content talent on the planet.

And heavily leveraging the Fullscreen acquisition that we did out of Otter Media, Fullscreen is obviously moving into a subscription model. We are really early to see how that progresses, but we're using that platform to do a lot of work for developing what I will call mobile-centric content, content that was designed for the mobile device.

And I'm very optimistic about what the opportunities are there. In terms of other more broader content ownership, there are a number of areas where we have what I will call proprietary content. We own a number of regional sports networks. Some of those we acquired through the DIRECTV acquisition. Others we have acquired over the course of the last year.

We also have a lot of what I will call exclusive content, content that is produced by us, everything from The Dan Patrick Show to a particular network we have on DIRECTV and some series like Kingdom and so forth. And Simon, you should expect us to continue to engage at that level, and as we have success, you'll see us invest more in the areas where we have success, but right now I think our plate is full doing full-scale integration of DIRECTV and bringing it into the mobility channel.

Simon Flannery (Analyst - Morgan Stanley):

Thank you.

Operator:

Frank Louthan, Raymond James.

Frank Louthan (Analyst - Raymond James):

Can you talk a little bit more on the mobility side about deals with Ford and so forth? Does that include getting maybe beyond new cars, but also getting into the used dealership networks?

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And then, on the Mexico side, can you comment on your aspirations for video with those customers there?

John Stephens (SEVP, CFO):

Yes, so the Ford deal is exclusively the cars coming off the manufacturing floor, and so those are new cars coming out over now and 2020. Like we said, we're expecting 10 million automobiles to roll off the floor between now and 2020 with our connectivity in it just from Ford.

You bring up an interesting point and that is there is a massive used-car fleet out there that is not connected, and there is actually technologies that are now available. I have a sports car, old sports car, that I now have connected to the Internet and it is actually a fairly elegant solution. And so, there are some capabilities that we are putting into the market -- in fact, we are selling into the market today -- to connect the used-car fleet that is out on the US roads.

And we think that's important because the average age of a car on the road today is 11 years, and so if you really want to grow this business, you need to tap into the used-car fleet. And so, that's a priority for us and you'll see us pursue that.

On Mexico and as it relates to the video opportunity, look, we are fairly convicted that mobile and video are going to be a category that is very, very relevant in the US. And we're early on here in the US, but based on early success, we continue to get more and more convicted that this is going to be an important category. Bringing the two together is going to be important.

And if it is going to be important in the US, we think it will be important in other markets, and Mexico will be no different. As you know, we have a minority share position in the satellite company in Mexico, and hopefully we will be able to do some partnering there, but we do think the video combination with mobile is going to be important in all geographies and all markets.

Frank Louthan (Analyst - Raymond James):

At some point, does it make sense to take a larger position in that ownership?

Randall Stephenson (Chairman & CEO):

I don't know if our partner has any interest in selling that position, so time will tell. We will just have to see.

Frank Louthan (Analyst - Raymond James):

All right, great. Thank you very much.

Operator:

Michael Rollins, Citi.

Michael Rollins (Analyst - Citigroup):

Just two, if I could. First, management in the past has discussed the investments in broadband within the wireline footprint over the last few years. Is there a way you can size the footprint where you have made the upgrades, but you are underpenetrated for broadband share? And help us think about the gap you hope to close, given the speeds that you are now offering.

And then if I could just throw in a second question, I was wondering if you could share some of the segmentations of how you spent capital in 2015, capital expenditures specifically, and how those

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allocations might change as you look at the 2016 budget? Thanks.

John Stephens (SEVP, CFO):

Yes, Mike, let me take a shot at this. With regard to our wireline footprint, we have about 60 million IP broadband-enabled customer locations for that from a consumer side, and we have got about 15 million IP broadband customers today. These are round numbers. The stack profile will give you the details, but with that, you can see that that is where our penetration right now is about 25%.

The key change here is the fact that we now have a national video product in DIRECTV and a satellite product, and such that we didn't have that before. So many of our, if you will, broadband-capable locations didn't have a video offering; now they do.

And so, as we improve this single truck roll capability, this sales channel capability, all of that, we expect to grow that share, and you can -- we would expect that it would be a significant improvement over where we are at today.

With regard to the expansion that we're doing now with regard to fiber, we are seeing very good results, and the ability to always have video available with the satellite product is going to prove, I think, to be very beneficial for us. So we will expand on that 60 million footprint over the next four years and we will also get to -- some of it will overlap, but we will get to 14 million fiber enabled and, quite frankly, there is a likelihood that we may get to more than that when we are finished.

So that's the way to think about that footprint issue.

With regard to the capital spend, why we don't go into great detail on the capital spend is because in our wireline and wireless footprint and for an integrated carrier, the spends become overlapping, whether you're taking high-speed backhaul to a cell site or whether you're shipping wireless traffic or wireline traffic out of an IP backbone.

But from a general perspective, in 2015 we spent probably about half of our capital in the wireless area, the other half in the wireline area, and if you will the parent of the two, the shared services area. I will tell you the pickup in the fourth quarter in part was due to Mexico and in part was due to the set-top box and the sales opportunities in DIRECTV .

So I will give you that way to think about it. I think that will be a consistent story as we go through the current years. We are investing at a rapid rate in all of our businesses.

The one thing about our wireless business is when you have got the tower network that we have today, the infrastructure that has been there, and you have the spectrum holdings that we have today, you can do great things with quality service, at least our network team can, do great service and continue to meet all the needs and you can be pretty effective with your capital spend.

It's not a situation where there is an investment; it is that much of this investment has been made over the last three years through the spectrum purchases, through the IP Project putting extensive fiber into the ground, and backhaul capabilities, and we're going to continue that, quite frankly, with GigaPower as we put more fiber near other cell sites that we can then get even better high-quality backhaul. So it's a really integrated process, but we -- needless to say, we continue to be very proud of the performance and continue to invest there.

Randall Stephenson (Chairman & CEO):

And don't forget software defined networking continues to push capital requirements down. Over the next three or four years, we think it is going to be significant.

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Operator:

Timothy Horan, Oppenheimer.

Timothy Horan (Analyst - Oppenheimer):

Just a couple follow-ups. John, so maybe just on the cash tax rate, could you give us maybe a little bit more color. I think Verizon said in the high 20% range. I know you reported taxes of 35% over the next few years. There is a lot of moving parts, but is mid-20% range look pretty good? And then a quick follow-up for Randall.

John Stephens (SEVP, CFO):

Yes, Tim, we're not going to (inaudible) but let me say it this way. I can completely understand how Verizon might be a similarly situated company could get to that level.

Timothy Horan (Analyst - Oppenheimer):

Got you. Randall, clearly there is unprecedented technological change with cloud and artificial intelligence and everything else going on, and you have had a lot of your peers slash CapEx and OpEx spending and Sprint seems like they're really on the road to doing that right now. But we have had a lot of European carriers do the same thing.

I guess the question I get a lot is, how much of a focus is it at AT&T and do you have confidence that you can see some of these benefits? And I guess maybe in that regard, I know you have Project Agile out there, and any kind of update on where you are in that process and ability to cut expenses, that would be great. Thanks.

Randall Stephenson (Chairman & CEO):

Yes, so when you think about software defined networking, as you think about the merger synergies from DIRECTV , $2.5 billion run rate synergies, you think about all that's going on in just the core business, you call it Project Agile -- John does -- where we're really just streamlining a lot of various operations, moving a lot of the customer interaction at their request to digital, the opportunity is really impressive to continue taking expense out of the business.

I would tell you if you look at just this quarter's results, it ought to give you some degree of comfort in terms of what is possible, even at a company of our size and our scale. Whether it is business solutions segment, our mobility segment, our entertainment group segment, consolidated -- I mean, it was a clean sweep in terms of taking margins up. And we weren't taking them up 5 or 10 basis points; the margins really moved up considerably.

And so, we feel really good about the path we are on and the momentum we have on the cost side of taking costs out of the business.

On the capital spending side, look, this is a unique opportunity. We're at a place where a lot of things are converging in terms of maturity that is going to create some incredible opportunities as we go forward. These ubiquitous high-speed mobile networks, they are here and they are ubiquitous. They are low latency. Combine that with cloud, combine that with data analytics capabilities that are available to the masses, right, the world of Big Data is here and it is available to everybody.

And then, sensors, the sensor technology, the ability to actually put in service sensors at virtually no -- the cost is nominal to put these sensors in place, millions upon millions of the sensors.

All of this, these four elements coming together at one time is a massive opportunity, and people not

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thinking about how to take advantage of ubiquitous mobility, high speed, low latency networks with cloud, with data analytics, with this sensor technology are going to miss it. And we think we are at a place right now where we have a unique position on bringing all this together and creating growth.

We're going to invest through this cycle. We're going to invest in video and making sure we can deliver video to our customers. We think that's going to be a huge opportunity, and expanding our footprint into Mexico. All of these are converging, we think, to give us a growth platform to the next four or five years that is unique.

So, we are trying to be prudent. Our downward bias on an incremental basis of capital, as we continue to emphasize that, we are being more and more efficient with our capital spend. John pointed out the implications of spectrum. Don't miss this. When you deploy these 2 by 10 megahertz blocks of spectrum, the efficiencies it brings to building and operating mobile networks is significant. And we think we're in a very unique position in that regard, too.

So I said in my opening comments and I will say it again, our intention is to deliver over these networks the most traffic at the lowest cost per bit to deliver. That's our objective and that's the path we are headed down, so we feel good about being able to achieve that.

So, Jim, thanks for the question and I also thank everybody for your participation on the call. We are off and running with the DIRECTV acquisition and Mexico. Those are going well, and we feel good about where we are as a business and looking forward to 2016. So thank you for your interest.

John Stephens (SEVP, CFO):

Thank you all; take care.

Operator:

Thank you. Ladies and gentlemen, that does conclude your conference call for today.

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