AT&T Inc. Financial Review 2008

Selected Financial and Operating Data

Dollars in millions except per share amounts

At December 31 or for the year ended:	2008	2007	2006[2]	2005[3]	2004
Financial Data[1]					
Operating revenues	**$124,028**	$118,928	$ 63,055	$ 43,764	$ 40,733
Operating expenses	**$100,965**	$ 98,524	$ 52,767	$ 37,596	$ 34,832
Operating income	**$ 23,063**	$ 20,404	$ 10,288	$ 6,168	$ 5,901
Interest expense	**$ 3,390**	$ 3,507	$ 1,843	$ 1,456	$ 1,023
Equity in net income of affiliates	**$ 819**	$ 692	$ 2,043	$ 609	$ 873
Other income (expense) – net	**$ (589)**	$ 615	$ 393	$ 397	$ 1,414
Income taxes	**$ 7,036**	$ 6,253	$ 3,525	$ 932	$ 2,186
Income from continuing operations	**$ 12,867**	$ 11,951	$ 7,356	$ 4,786	$ 4,979
Income from discontinued operations, net of tax[4]	**$ —**	$ —	$ —	$ —	$ 908
Net income	**$ 12,867**	$ 11,951	$ 7,356	$ 4,786	$ 5,887
Earnings per common share:					
Income from continuing operations	**$ 2.17**	$ 1.95	$ 1.89	$ 1.42	$ 1.50
Net income	**$ 2.17**	$ 1.95	$ 1.89	$ 1.42	$ 1.78
Earnings per common share – assuming dilution:					
Income from continuing operations	**$ 2.16**	$ 1.94	$ 1.89	$ 1.42	$ 1.50
Net income	**$ 2.16**	$ 1.94	$ 1.89	$ 1.42	$ 1.77
Total assets	**$265,245**	$275,644	$270,634	$145,632	$110,265
Long-term debt	**$ 60,872**	$ 57,255	$ 50,063	$ 26,115	$ 21,231
Construction and capital expenditures	**$ 20,335**	$ 17,888	$ 8,393	$ 5,612	$ 5,130
Dividends declared per common share	**$ 1.61**	$ 1.47	$ 1.35	$ 1.30	$ 1.26
Book value per common share	**$ 16.35**	$ 19.09	$ 18.52	$ 14.11	$ 12.27
Ratio of earnings to fixed charges	**4.75**	4.91	5.01	4.11	6.32
Debt ratio	**43.8%**	35.7%	34.1%	35.9%	40.0%
Weighted-average common shares outstanding (000,000)	**5,927**	6,127	3,882	3,368	3,310
Weighted-average common shares outstanding with dilution (000,000)	**5,958**	6,170	3,902	3,379	3,322
End of period common shares outstanding (000,000)	**5,893**	6,044	6,239	3,877	3,301
Operating Data					
Wireless customers (000)[5]	**77,009**	70,052	60,962	54,144	49,132
In-region network access lines in service (000)[6]	**55,610**	61,582	66,469	49,413	52,356
Broadband connections (000)[7]	**16,322**	14,802	12,170	6,921	5,104
Number of employees	**302,660**	309,050	304,180	189,950	162,700

[1]Amounts in the above table have been prepared in accordance with U.S. generally accepted accounting principles.
[2]Our 2006 income statement amounts reflect results from BellSouth Corporation (BellSouth) and AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC, for the two days following the December 29, 2006 acquisition. Our 2006 balance sheet and end-of-year metrics include 100% of BellSouth and AT&T Mobility. Prior to the December 29, 2006 BellSouth acquisition, AT&T Mobility was a joint venture in which we owned 60% and was accounted for under the equity method.
[3]Our 2005 income statement amounts reflect results from AT&T Corp. for the 43 days following the November 18, 2005 acquisition. Our 2005 balance sheet and end-of-year metrics include 100% of AT&T Corp.
[4]Our financial statements reflect results from our sold directory advertising business in Illinois and northwest Indiana as discontinued operations. The operational results and the gain associated with the sale of that business are presented in "Income from discontinued operations, net of tax."
[5]The number presented represents 100% of AT&T Mobility cellular/PCS customers. The 2004 number includes customers from the acquisition of AT&T Wireless Services, Inc.
[6]In-region represents access lines serviced by our incumbent local exchange companies (in 22 states since the BellSouth acquisition and in 13 states prior to that acquisition). Beginning in 2006, the number includes BellSouth lines in service.
[7]Broadband connections include in-region DSL lines, in-region U-verse high-speed Internet access, satellite broadband and 3G LaptopConnect cards.

Dollars in millions except per share amounts

For ease of reading, AT&T Inc. is referred to as "we," "AT&T" or the "Company" throughout this document and the names of the particular subsidiaries and affiliates providing the services generally have been omitted. AT&T is a holding company whose subsidiaries and affiliates operate in the communications services industry both in the United States and internationally providing wireless and wireline telecommunications services and equipment as well as directory advertising and publishing services.

You should read this discussion in conjunction with the consolidated financial statements and accompanying notes. A reference to a "Note" in this section refers to the accompanying Notes to Consolidated Financial Statements. In the tables throughout this section, percentage increases and decreases that equal or exceed 100% are not considered meaningful and are denoted with a dash.

RESULTS OF OPERATIONS

Consolidated Results Our financial results are summarized in the table below. We then discuss factors affecting our overall results for the past three years. These factors are discussed in more detail in our "Segment Results" section. We also discuss our expected revenue and expense trends for 2009 in the "Operating Environment and Trends of the Business" section.

We completed our acquisition of BellSouth Corporation (BellSouth) on December 29, 2006. We thereby acquired BellSouth's 40% economic interest in AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC (Cingular), resulting in 100% ownership of AT&T Mobility. Our consolidated results in 2006 include BellSouth's and AT&T Mobility's operational results for the final two days of the year. Prior to the acquisition, we reported the income from our 60% share of AT&T Mobility as equity in net income. In accordance with U.S. generally accepted accounting principles (GAAP), operating results from BellSouth and AT&T Mobility prior to their respective acquisition dates are excluded.

				Percent Change	
	2008	2007	2006	**2008 vs. 2007**	2007 vs. 2006
Operating revenues	**$124,028**	$118,928	$63,055	**4.3%**	88.6%
Operating expenses	**100,965**	98,524	52,767	**2.5**	86.7
Operating income	**23,063**	20,404	10,288	**13.0**	98.3
Income before income taxes	**19,903**	18,204	10,881	**9.3**	67.3
Net income	**12,867**	11,951	7,356	**7.7**	62.5
Diluted earnings per share	**2.16**	1.94	1.89	**11.3**	2.6

Overview

Operating income As noted above, 2007 revenues and expenses reflect the addition of BellSouth's and AT&T Mobility's results while our 2006 results only include two days of their results. Accordingly, the following discussion of changes in our revenues and expenses is affected by these acquisitions.

Our operating income increased $2,659, or 13.0%, in 2008 and $10,116, or 98.3%, in 2007. Our operating income margin increased from 16.3% in 2006 to 17.2% in 2007 and to 18.6% in 2008. Operating income in 2008 increased primarily due to continued growth in wireless service and data revenues along with a decrease in the amortization of merger-related intangibles and increased in 2007 primarily due to the acquisition of BellSouth. Reported results in 2008 include directory revenue and expenses from directories published by BellSouth subsidiaries. In accordance with GAAP, our reported results in 2007 did not include deferred revenue of $964 and expenses of $308 from BellSouth directories published during the 12-month period ending with the December 29, 2006 date we acquired BellSouth. Had our 2007 directory results included this deferred revenue and expenses, operating income would have increased $2,003 for 2008, as compared to 2007.

Operating revenues increased $5,100, or 4.3%, in 2008 and $55,873, or 88.6%, in 2007. Revenues in 2008 reflect an increase in wireless subscribers and data revenues, primarily related to Internet Protocol (IP) data, partially offset by the continued decline in voice revenues. Increases in 2007 were primarily due to our acquisitions and to continuing growth in wireless subscribers. As discussed above, purchase accounting treatment for directories published 12 months prior to the BellSouth acquisition also increased revenues in 2008 when compared to 2007.

Our operating revenues also reflect the continued decline of our retail access lines due to the dramatically declining overall economy and increased competition, as customers continued to disconnect both primary and additional lines and switched to wireless, Voice over Internet Protocol (VoIP) and cable offerings for voice and data. While we lose the wireline voice revenues, we have the opportunity to increase wireless service revenue should customers choose AT&T Mobility as their alternative provider.

Operating expenses increased $2,441, or 2.5%, in 2008 and $45,757, or 86.7%, in 2007. The increase in 2008 was primarily due to higher equipment costs related to the successful launch of the Apple iPhone 3G and increased sales of PDA devices, while the increase in 2007 was primarily due to merger integration costs and amortization expense on intangible assets identified at the time of acquisition. Also increasing 2008 expenses were higher commissions and residuals from the growth in wireless, severance associated with announced workforce reductions as well as hurricane-related expenses affecting both the wireless and wireline segments. Partially offsetting these increases were merger integration costs recognized in 2007 and not in 2008, and lower amortization expense on intangible assets in 2008.

Interest expense decreased $117, or 3.3%, in 2008 and increased $1,664, or 90.3%, in 2007. Interest expense remained relatively unchanged during 2008 with a decrease in our weighted average interest rate and increases in interest charged during construction, offset by an increase in our average debt balances. Future interest expense will continue to reflect increased interest during construction related to preparing 2008 spectrum purchases for service. The increase in 2007 was primarily due to higher average debt balances resulting from the inclusion of BellSouth and AT&T Mobility outstanding debt on our consolidated balance sheet.

Dollars in millions except per share amounts

Equity in net income of affiliates Equity in net income of affiliates increased $127, or 18.4%, in 2008, primarily due to improved results from our investments in América Móvil S.A. de C.V. (América Móvil), Télefonos de México, S.A. de C.V. (Telmex) and Telmex Internacional, S.A.B. de C.V. (Telmex Internacional) offset by foreign exchange adjustments. Equity in net income of affiliates decreased $1,351 in 2007 as a result of the change in accounting for AT&T Mobility which moved Mobility's results from this line. Prior to the December 29, 2006 BellSouth acquisition (see Note 2), we accounted for our 60% economic interest in AT&T Mobility under the equity method since we shared control equally with BellSouth. AT&T Mobility is now a wholly-owned subsidiary of AT&T, and wireless results are reflected in operating revenues and expenses in our consolidated statements of income.

Other income (expense) – net We had other expense of $589 in 2008, and other income of $615 in 2007 and $393 in 2006. Results for 2008 included losses of $467 related to asset impairments, $261 in minority interest expense and $180 loss on the sale of merger-related investments held under independent management which support certain benefit plans (see Note 11). These losses were partially offset by a $121 gain on the disposition of other non-strategic assets, $107 gain related to interest income, $49 of income from leveraged leases and $41 of dividend income.

Other income for 2007 included gains of $409 related to a wireless spectrum license exchange, $166 in interest income, $148 from the sale of administrative buildings and other non-strategic assets, and $88 from other non-operating activities. These gains were partially offset by $196 in minority interest expense. Other income for 2006 included interest income of $377. There were no other individually significant other income or expense transactions during 2006.

Income taxes increased $783, or 12.5%, in 2008 and $2,728, or 77.4%, in 2007. The increase in income taxes in 2008 was primarily due to higher operating income. Our effective tax rate in 2008 was 35.4%, compared to 34.4% in 2007 and 32.4% in 2006. The increase in our effective tax rate for 2008 was primarily due to an increase in income before income taxes.

The increase in income taxes in 2007 compared to 2006 was primarily due to higher operating income reflecting the acquisition of BellSouth and its share of AT&T Mobility's operating results. The increase in our effective tax rate for 2007 was primarily due to the consolidation of AT&T Mobility and an increase in income before income taxes.

Supplemental Information

To provide improved comparability versus previous results, below is a supplemental table providing pro forma consolidated operating revenues for 2006, assuming the closing date for the BellSouth acquisition was January 1, 2006, along with a summary of how these 2006 pro forma numbers would have affected 2007 results. The 2008 results are included to provide trend information but the comparisons between 2008 and 2007 results are discussed in "Segment Results."

Supplemental Consolidated Operating Revenues Information

				Percent Change
	Actual 2008	Actual 2007	Pro Forma 2006	2007 vs. 2006
Segment operating revenues				
Wireless service	**$ 44,249**	$ 38,568	$ 33,692	14.5%
Voice	**37,321**	40,798	43,505	(6.2)
Data	**24,372**	23,206	22,173	4.7
Directory	**5,416**	4,806	5,823	(17.5)
Other	**12,670**	11,550	11,861	(2.6)
Total Operating Revenues	**$124,028**	$118,928	$117,054	1.6%

Pro forma wireless service growth in 2007 was driven by subscriber growth and strong increases in data usage, including increased messaging, browsing, media bundles and both laptop and smartphone connectivity. We have historically discussed our wireless segment results on a basis that included 100% of AT&T Mobility results, and a detailed wireless service revenue discussion can be found in our "Wireless Segment Results" section.

The pro forma voice revenue decline in 2007 is consistent with trends and is due to access line declines reflecting competition and substitution of alternative technologies, pricing pressures due to competition, anticipated shifts of traffic by major consolidated carriers to their own networks and a continuing decline in the number of AT&T Corp.'s (ATTC) mass-market customers, which are composed of consumers and small businesses.

Pro forma data growth was led by an increase in IP data revenues of 13.3% in 2007, with strength in high-speed Internet, managed Internet, Virtual Private Network (VPN) and hosting services. Data transport service revenues were up 0.7% in 2007, and packet-switched data revenues, which include frame relay and asynchronous transfer mode (ATM) services, were down 7.0%, consistent with the industry trend of customers switching to IP-based services from traditional circuit-based services.

Directory results were lower in 2007 due to the purchase accounting treatment of directories delivered by BellSouth's advertising and publishing businesses in the 12 months prior to the merger (see Note 4). In accordance with GAAP, the deferred revenues from these books were not included in the 2007 consolidated directory revenues. Had those deferred revenues been included in 2007, directory revenues would have increased by $964. The pro forma revenues for 2006 do not reflect this purchase accounting treatment of deferred directory revenues.

Pro forma other revenues decreased in 2007 due to our decision to de-emphasize sales of lower-margin, stand-alone customer premises equipment.

Segment Results

Our segments are strategic business units that offer different products and services and are managed accordingly. As a result of our acquisitions of BellSouth and ATTC, we revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segments. Our operating segment results presented in Note 4 and discussed below for each segment follow our internal management reporting. We analyze our various operating segments based on segment income before income taxes. Each segment's percentage of total segment operating revenue and income calculations is derived from our segment results table in Note 4 and reflects amounts before eliminations. We have four reportable segments: (1) wireless, (2) wireline, (3) advertising & publishing and (4) other.

The ***wireless segment*** accounted for approximately 39% of our 2008 total segment operating revenues as compared to 35% in 2007 and 46% of our 2008 total segment income as compared to 32% in 2007. This segment offers wireless voice and data communications services across the United States. This segment reflects 100% of the results reported by AT&T Mobility, which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. Prior to the acquisition, although we analyzed AT&T Mobility's revenues and expenses under the wireless segment, we eliminated the wireless segment in our consolidated financial statements. In our 2006 and prior consolidated financial statements we reported our 60% proportionate share of AT&T Mobility's results as equity in net income of affiliates.

The ***wireline segment*** accounted for approximately 55% of our 2008 total segment operating revenues as compared to 59% in 2007 and 47% of our 2008 total segment income as compared to 55% in 2007. This segment provides both retail and wholesale landline communications services, including local and long-distance voice, switched access, IP and Internet access data, messaging services, managed networking to business customers, AT&T U-verse℠ TV service and satellite television services through our agency agreements.

The ***advertising & publishing segment*** accounted for approximately 4% of our 2008 total segment operating revenues as compared to 5% in 2007 and 7% of our 2008 total segment income as compared to 9% in 2007. This segment includes our directory operations, which publish Yellow and White Pages directories and sell directory advertising, Internet-based advertising and local search. For 2007, this segment includes 100% of the results of YELLOWPAGES.COM (YPC), which was a joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T.

Under Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), deferred revenue and expenses from BellSouth directories published during the 12-month period ending with the December 29, 2006 acquisition date were not recognized in 2007 consolidated results. Accordingly, our consolidated revenue and expenses in 2007 related to directory operations were lower. Because management assesses the performance of the segment including the revenue and expenses associated with those directories, for segment reporting purposes, our 2007 advertising & publishing segment results include revenues of $964 and expenses of $308, related to directories published prior to our acquisition of BellSouth. These amounts are eliminated in our consolidated results (see Note 4).

The ***other segment*** accounted for approximately 2% of our 2008 total segment operating revenues as compared to 1% in 2007 and less than 1% of our 2008 total segment income as compared to 4% in 2007. This segment includes results from Sterling Commerce, Inc. (Sterling), customer information services, payphone, and all corporate and other operations. During 2008, we announced our intention to discontinue our retail payphone operations. Additionally, this segment includes our portion of the results from our international equity investments and charges of $978 associated with our workforce reductions announced in 2008. Prior to December 29, 2006, this segment also included our results from AT&T Mobility as equity in net income of affiliates, as discussed above.

The following tables show components of results of operations by segment. We discuss significant segment results following each table. We discuss capital expenditures for each segment in "Liquidity and Capital Resources."

Dollars in millions except per share amounts

Wireless
Segment Results

				Percent Change	
	2008	2007	2006	**2008 vs. 2007**	2007 vs. 2006
Segment operating revenues					
Service	**$44,410**	$38,678	$33,788	**14.8%**	14.5%
Equipment	**4,925**	4,006	3,749	**22.9**	6.9
Total Segment Operating Revenues	**49,335**	42,684	37,537	**15.6**	13.7
Segment operating expenses					
Cost of services and equipment sales	**18,078**	15,991	15,057	**13.1**	6.2
Selling, general and administrative	**14,403**	12,594	11,446	**14.4**	10.0
Depreciation and amortization	**5,770**	7,079	6,462	**(18.5)**	9.5
Total Segment Operating Expenses	**38,251**	35,664	32,965	**7.3**	8.2
Segment Operating Income	**11,084**	7,020	4,572	**57.9**	53.5
Equity in Net Income of Affiliates	**6**	16	40	**(62.5)**	(60.0)
Minority Interest[1]	**(256)**	(198)	(169)	**(29.3)**	(17.2)
Segment Income	**$10,834**	$ 6,838	$ 4,443	**58.4%**	53.9%

[1]Minority interest is recorded as "Other Income (Expense) – Net" in the consolidated statements of income.

Accounting for AT&T Mobility
The wireless segment reflects 100% of the results reported by AT&T Mobility, which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition, at which time it became a wholly-owned subsidiary of AT&T. Prior to the BellSouth acquisition (see Note 2), we accounted for our 60% economic interest in AT&T Mobility under the equity method since we shared control equally with BellSouth. This means that our 2006 consolidated results included our 60% share of AT&T Mobility's results in "Equity in net income of affiliates" in our consolidated statements of income. Following the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary and AT&T Mobility's results are now included as operating revenues and expenses in our consolidated statements of income. Accordingly, results from this segment for the last two days of 2006 were included in our operating revenues and expenses and not in the "Equity in net income (loss) of affiliates" line. However, for all the periods presented, the wireless segment reflects 100% of the results reported by AT&T Mobility based on the management of the business.

Dobson Acquisition
In November 2007, we acquired Dobson Communications Corporation (Dobson). Dobson marketed wireless services under the Cellular One brand and had provided roaming services to AT&T subsidiaries since 1990. Dobson had 1.7 million subscribers across 17 states, mostly in rural and suburban areas. Dobson was incorporated into our wireless operations subsequent to its acquisition.

Wireless Customer and Operating Trends
As of December 31, 2008, we served 77.0 million wireless customers, compared to 70.1 million at December 31, 2007, and 61.0 million at December 31, 2006. Approximately 69% of our wireless customer net additions in 2008 were postpaid customer additions. Contributing to our net additions and retail customer growth was improvement in postpaid customer turnover (customer churn) levels due to our strong network performance and attractive products and services offerings, including the Apple iPhone. The improvement in churn levels benefited from network and customer service improvements and continued high levels of advertising. Gross customer additions were 21.4 million in 2008, 20.1 million in 2007 and 19.2 million in 2006. Postpaid customer gross additions increased approximately 8.4% primarily due to attractive plan offerings and exclusive product offerings such as the Apple iPhone, BlackBerry® Bold and unique quick messaging devices.

As the wireless industry continues to mature, we believe that future wireless growth will become increasingly dependent on our ability to offer innovative services, which will encourage existing customers to upgrade their current services and handsets and will attract customers from other providers, as well as on our ability to minimize customer churn. Average service revenue per user/customer (ARPU) increased approximately 1% compared to 2007 primarily due to increased data services ARPU growth. ARPU from postpaid customers increased 3.7% reflecting usage of more advanced handsets, such as the Apple iPhone 3G, by these customers. In 2008, data services ARPU grew 33.8% compared to 2007. The continued increase in data revenue was related to increased use of text messaging, Internet access, e-mail and other data services. We expect continued growth from data services as more customers purchase advanced handsets, such as iPhone 3G, and laptop cards and as our third-generation network continues to expand. The growth in data ARPU was partially offset by a decline in voice service ARPU of 6.5% compared to 2007. The decline in voice service ARPU is the result of a decrease in postpaid voice overage charges, increases in our Family Talk® and reseller customers, which have lower ARPU than traditional postpaid customers, lower roaming revenues due to acquisitions and rate negotiations as part of roaming cost savings initiatives, slowing international growth and lower regulatory cost recovery charges. We expect continued pressure on voice service ARPU.

In 2007, data service ARPU grew 46.9% compared to 2006. The continued increase in data revenue was related to increased use of text messaging, Internet access, e-mail and other data services. The growth in data ARPU was partially offset by a decline in voice service ARPU of 4.1% compared to 2006, reflecting a higher percentage of prepaid and reseller customers, which provide significantly lower ARPU than postpaid customers, and continued shifts to all-inclusive rate plans that offer lower monthly charges.

The effective management of customer churn also is critical to our ability to maximize revenue growth and to maintain and improve margins. Customer churn is calculated by dividing the aggregate number of wireless customers who cancel service during each month in a period by the total number of wireless customers at the beginning of each month in that period. Our customer churn rate was 1.7% in 2008, 1.7% in 2007 and 1.8% in 2006. The churn rate for postpaid customers was 1.2% in 2008, down from 1.3% in 2007 and 1.5% in 2006. The decline in postpaid churn reflects higher network quality and broader coverage, more affordable rate plans as well as exclusive devices and free mobile-to-mobile calling among our wireless customers.

Wireless Operating Results

Our wireless segment operating income margin was 22.5% in 2008, 16.4% in 2007 and 12.2% in 2006. The higher margin in 2008 was primarily due to revenue growth of $6,651, which exceeded our increase in operating expenses of $2,587, which included a decrease in depreciation and amortization of $1,309. The higher margin in 2007 was primarily due to revenue growth of $5,147, which exceeded our increase in operating expenses of $2,699.

Service revenues are comprised of local voice and data services, roaming, long-distance and other revenue. Service revenues increased $5,732, or 14.8%, in 2008 and $4,890, or 14.5%, in 2007 and consisted of:

- Data revenue increases of $3,647, or 52.5%, in 2008 and $2,692, or 63.3%, in 2007. The increase in 2008 is primarily due to the increased number of data users and the above noted increase in data ARPU of 33.8%. Our significant data growth also reflects an increased number of subscribers using our 3G network. The increase in 2007 was related to increased use of text messaging and Internet access services, which resulted in an increase in data ARPU of 46.9%. Data service revenues represented approximately 23.9% of our wireless segment service revenues in 2008 and 18.0% in 2007.
- Voice revenue increases of $2,076, or 6.6%, in 2008 and $2,135, or 7.3%, in 2007. The increase in 2008 was primarily due to an increase in the number of average wireless customers of approximately 14%, partially offset by a decline in voice ARPU of 6.5%. The increase in 2007 was primarily due to an increase in the average number of wireless customers of approximately 12%, partially offset by a decline in voice ARPU of 4.1%. Included in voice revenues for both periods were increases in long-distance and net roaming revenue due to increased international usage.

Equipment revenues increased $919, or 22.9%, in 2008 and $257, or 6.9%, in 2007. The increase in both 2008 and 2007 was due to higher handset revenues reflecting increased gross customer additions and customer upgrades to more advanced handsets. The increase in 2007 was partially offset by equipment discounts and rebate activity.

Cost of services and equipment sales expenses increased $2,087, or 13.1%, in 2008 and $934, or 6.2%, in 2007. The 2008 and 2007 increases were primarily due to increased equipment sales expense of $2,005 and $1,140, respectively, resulting from the overall increase in sales as well as an increase in sales of higher-cost 3G devices, the introduction of the Apple iPhone 3G (in 2008) and iPhone (in 2007) handsets as well as an increase in the number of handset accessory sales. The 2008 per-unit accessory cost decreased from 2007, while the 2007 per-unit accessory cost increased from 2006. Total equipment costs continue to be higher than equipment revenues due to the sale of handsets below cost, through direct sales sources, to customers who committed to one-year or two-year contracts or in connection with other promotions.

Excluding equipment sales, costs of services remained relatively flat in 2008 as the result of higher regulatory fees of $204 due to revenue growth, reseller costs of $145, and interconnect and other costs of $141, substantially offset by lower incollect roaming costs of $249, network system costs of $132 and long-distance costs of $27.

The $145 increase in reseller costs is attributable to higher license, maintenance and other reseller costs partly offset by cost reductions from the migration of network usage from the T-Mobile USA (T-Mobile) network in California and Nevada to our networks in these states. Our remaining purchase commitment to T-Mobile for this transition period was $42 and $51 at December 31, 2008 and 2007, respectively.

The $141 increase in interconnect and other costs primarily related to increased usage and integration costs related to Dobson. The $132 decrease in network system costs is the result of benefits from network and systems integration and cost-reduction initiatives of $218, and lower data processing and payroll costs of $109, partly offset by incremental rents related to Dobson and general building expense increases of $124, and hurricane and other incremental network costs of $99.

Dollars in millions except per share amounts

Cost of services declined $206 in 2007. This decline was due to lower interconnect, roaming and long-distance expenses related to network and systems integration and cost-reduction initiatives, as well as cost reductions from the migration of network usage from the T-Mobile network. These decreases were partially offset by higher network usage, with increases in total system minutes of use of 13.5%, and associated network system expansion and increased network equipment costs.

Selling, general and administrative expenses increased $1,809, or 14.4%, in 2008 and $1,148, or 10.0%, in 2007.

The increase in selling, general and administrative expenses in 2008 was due to the following:

- Increases of $702 in customer costs and other expenses primarily due to increased customer service costs of $159, customer maintenance costs of $240, bad debt expense of $49 and other support costs of $298, partially offset by a decline of $44 in billing expenses.
- Increases in selling expenses of $362 due to increases in commissions expense, sales and marketing expenses partly attributable to the introduction of the Apple iPhone 3G.
- Increases in upgrade commission and residual expenses of $745 due to higher handset upgrade volume and commission rates.

The increase in selling, general and administrative expenses in 2007 was due to the following:

- Increases in selling expenses of $572 due to increases in sales and advertising expenses and Apple iPhone related costs, partially offset by a decrease in net commission expense, which was consistent with the increase in prepaid plan sales as a percentage of total retail sales.
- Increases of $572 in customer maintenance and other expenses primarily due to increased bad debt expense of $338 and other support costs of $234, partially offset by a decline of $191 in billing expenses, lower information technology (IT) and customer service expenses.
- Increases in upgrade commission and residual expenses of $195 due to increased prepaid plan costs and higher handset upgrade activity.

Depreciation and amortization decreased $1,309, or 18.5%, in 2008 and increased $617, or 9.5%, in 2007. The decrease in 2008 was due to lower amortization expense of $770 and lower depreciation expense of $539. The decrease in amortization expense is attributable to declining amortization of identifiable intangible assets, which are principally amortized using the sum-of-the-months-digits method of amortization, partially offset by incremental amortization on Dobson intangible assets acquired by AT&T Mobility. Depreciation expense decreased $695 due to certain network assets becoming fully depreciated and decreased $612 due to Time Division Multiple Access (TDMA) assets being depreciated on an accelerated basis through 2007. These decreases were partly offset by incremental depreciation on capital assets placed in service during 2008.

The increase in 2007 was primarily due to an increase of $1,522 in amortization of identifiable intangible assets related to our acquisition of BellSouth's 40% ownership interest, partially offset by declining amortization of identifiable AT&T Wireless Services, Inc. intangible assets acquired by AT&T Mobility in 2004. Expenses also increased due to accelerated depreciation on TDMA assets and ongoing capital spending for network upgrades and expansion. The 2007 increase was partially offset by decreases in depreciation expense of $905 due to certain network assets becoming fully depreciated and purchase accounting adjustments on certain network assets related to acquiring BellSouth's 40% ownership interest of AT&T Mobility.

Wireline
Segment Results

				Percent Change	
	2008	2007	2006	**2008 vs. 2007**	2007 vs. 2006
Segment operating revenues					
Voice	**$38,198**	$41,630	$33,714	**(8.2)%**	23.5%
Data	**25,352**	24,075	18,317	**5.3**	31.4
Other	**6,304**	5,878	5,442	**7.2**	8.0
Total Segment Operating Revenues	**69,854**	71,583	57,473	**(2.4)**	24.6
Segment operating expenses					
Cost of sales	**31,929**	31,018	27,388	**2.9**	13.3
Selling, general and administrative	**13,624**	15,159	12,205	**(10.1)**	24.2
Depreciation and amortization	**13,150**	13,416	9,682	**(2.0)**	38.6
Total Segment Operating Expenses	**58,703**	59,593	49,275	**(1.5)**	20.9
Segment Income	**$11,151**	$11,990	$ 8,198	**(7.0)%**	46.3%

Operating Margin Trends

Our wireline segment operating income margin was 16.0% in 2008, compared to 16.7% in 2007 and 14.3% in 2006. Results for 2008 reflect revenue declines that exceeded expense declines. Our wireline segment operating income decreased $839, or 7.0%, in 2008 and increased $3,792 in 2007 primarily reflecting the addition of BellSouth's operating results in 2007. Our operating income continued to be pressured by access line declines due to increased competition, as customers disconnected both primary and additional lines and switched to alternative technologies, such as wireless, VoIP and cable for voice and data. The deteriorating economy during 2008 also adversely affected our customers' ability to purchase and maintain both wireline and wireless services. Our strategy is to offset these line losses by increasing non-access-line-related revenues from customer connections for data, video and voice. Additionally, we have the opportunity to increase wireless segment revenues if customers choose AT&T Mobility as an alternative provider. As noted above, 2007 revenues and expenses reflect the addition of BellSouth's results while our 2006 results only include two days of their results. Accordingly, the following discussion of changes in our revenues and expenses is affected by this acquisition.

Voice revenues decreased $3,432, or 8.2%, in 2008 primarily due to declining demand for traditional voice services and increased $7,916, or 23.5%, in 2007. Included in voice revenues are revenues from local voice, long-distance and local wholesale services. Voice revenues do not include VoIP revenues, which are included in data revenues.

- Local voice revenues decreased $1,887, or 7.7%, in 2008 and increased $6,831, or 38.4%, in 2007. The decrease in 2008 was driven primarily by loss of revenue of $1,230 from a decline in access lines and by $422 from a decline from ATTC's mass-market customers. The increase in 2007 was primarily due to the acquisition of BellSouth, which increased local voice revenues approximately $8,040. Local voice revenues also increased in 2007 due to pricing increases for regional telephone service, custom calling features and inside wire maintenance agreements. Local voice revenues in 2007 were negatively impacted by expected declines in revenues from ATTC's mass-market customers and from customer demand-related declines for calling features and inside wire agreements. We expect our local voice revenue to continue to be negatively affected by increased competition from alternative technologies, the disconnection of additional lines and the deteriorating economy.
- Long-distance revenues decreased $1,195, or 7.9%, in 2008 and increased $761, or 5.3%, in 2007 primarily due to the acquisition of BellSouth, which increased long-distance revenues approximately $2,075. The decrease in 2008 was primarily due to a net decrease in demand for long-distance service, due to expected declines in the number of ATTC's mass-market customers, which decreased revenues $677 and decreased demand from global and consumer customers, which decreased revenues $532.
- Local wholesale revenues decreased $350, or 18.7%, in 2008 and increased $324, or 20.9%, in 2007. The decrease in 2008 was primarily due to the declining number of competitive providers using local wholesale lines. However, this declining revenue trend stabilized in the second half of 2008 since industry consolidation and local wholesale line loss has slowed. The increase in 2007 was primarily due to the acquisition of BellSouth, which increased local wholesale revenues approximately $615. Wholesale revenue decreased in 2007 due to industry consolidation as certain customers moved more traffic to their own networks.

Data revenues increased $1,277, or 5.3%, in 2008 and increased $5,758, or 31.4%, in 2007. Data revenues accounted for approximately 36% of wireline operating revenues in 2008, 34% in 2007 and 32% in 2006. Data revenues include transport, IP and packet-switched data services.

IP data revenues increased $1,537, or 16.1%, in 2008 primarily due to growth in consumer and business broadband, VPNs and managed Internet services, and increased $3,080, or 47.6%, in 2007 primarily due to the acquisition of BellSouth, which increased IP data approximately $2,235. Broadband high-speed Internet access increased IP data revenues $498 in 2008. The increase in broadband revenues was partially offset by the decline in revenue due to the renegotiation of our Yahoo! agreement which took effect April 2008. VPNs increased $477 and various other IP data services such as U-verse video and dedicated Internet access services contributed $535 to the increase in 2008. The increase in IP data revenues in 2008 and 2007 reflects continued growth in the customer base and migration from other traditional circuit-based services.

Our transport services increased $163, or 1.4%, in 2008, primarily due to continuing volume growth in Ethernet (types of high-capacity switched lines), ISDN and international private lines. These increases were partially offset by declines in usage-based transport services used by our largest business customers. In 2007, transport services revenues increased $2,640, or 29.7%, due to the acquisition of BellSouth.

Our traditional circuit-based services, which include frame relay, asynchronous transfer mode and managed packet services, decreased $423, or 14.1%, in 2008. This decrease is primarily due to lower demand as customers continue to shift to IP-based technology such as VPNs, broadband and managed Internet services. We expect these traditional services to continue to decline as a percentage of our overall data revenues. In 2007, circuit-based services revenues increased $38, or 1.3%, primarily due to the acquisition of BellSouth, which increased circuit-based services revenues $265.

Other operating revenues increased $426, or 7.2%, in 2008 and $436, or 8.0%, in 2007. Major items included in other operating revenues are integration services and customer premises equipment, government-related services and outsourcing, which account for more than 60% of total revenue for all periods. Equipment sales and related network integration and management services increased $260 in

2008, driven by an increase in management services, and decreased $274 in 2007 primarily due to less emphasis on the sale of lower-margin equipment. Governmental professional services revenue increased $100 in 2008 driven by growth across various contracts. Revenue also decreased by $70 in 2007 due to the recognition of intellectual property license fees in 2006 that did not recur in 2007. More than offsetting these declines in 2007 was incremental revenue from our acquisition of BellSouth.

Cost of sales expenses increased $911, or 2.9%, in 2008 and $3,630, or 13.3%, in 2007. Cost of sales consists of costs we incur in order to provide our products and services, including costs of operating and maintaining our networks and personnel costs, such as salary, wage and bonus accruals. Costs in this category include our repair technicians and repair services, certain network planning and engineering expenses, operator services, IT and property taxes related to elements of our network. Pension and postretirement costs, net of amounts capitalized as part of construction labor, are also included to the extent that they are associated with these employees.

Cost of sales in 2008 increased due to the following:

- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $1,056.
- Salary and wage merit increases, other bonus accruals and higher employee levels, which increased compensation expenses by $423 and increased medical and other benefits by $239.
- Higher cost of equipment sales and related network integration services of $60 in 2008 primarily due to increased U-verse customers partially offset by reductions due to less emphasis on sales of lower-margin equipment.

Partially offsetting these increases, cost of sales in 2008 decreased due to:

- Lower traffic compensation expenses (for access to another carrier's network) of $633 primarily due to reduced portal fees from renegotiation of our agreement with Yahoo!, continued migration of long-distance calls onto our network and a lower volume of calls from ATTC's declining national mass-market customer base.
- Lower net pension and postretirement cost of $387, primarily due to changes in our actuarial assumptions, including the increase of our discount rate from 6.00% to 6.50% (a decrease to expense) and favorable prior-year investment returns on plan assets resulting in a decrease in the recognition of net losses from prior years.

In addition to the impact of the BellSouth acquisition, cost of sales in 2007 increased due to the following:

- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $605.
- Higher expenses of $225 in 2007 due to a 2006 change in our policy regarding the timing for earning vacation days, which reduced expense in 2006.
- Salary and wage merit increases and other bonus accruals of $165.

Partially offsetting these increases, cost of sales in 2007 decreased due to:

- Lower traffic compensation expenses (for access to another carrier's network) of $831 primarily due to migration of long-distance calls onto our network and a lower volume of calls from ATTC's declining national mass-market customer base.
- Lower net pension and postretirement cost of $398, primarily due to changes in our actuarial assumptions, including the increase of our discount rate from 5.75% to 6.00% (a decrease to expense) and favorable investment returns on plan assets resulting in a decrease in the recognition of net losses from prior years.
- Lower cost of equipment sales and related network integration services of $300, primarily due to less emphasis on sales of lower-margin equipment. Costs associated with equipment for large-business customers typically are greater than costs associated with services that are provided over multiple years.
- Lower expenses of $163 in 2007 due to the discontinuance of DSL Universal Service Fund fees in the third quarter of 2006.

Selling, general and administrative expenses decreased $1,535, or 10.1%, in 2008 and increased $2,954, or 24.2%, in 2007. Selling, general and administrative expenses consist of our provision for uncollectible accounts; advertising costs; sales and marketing functions, including our retail and wholesale customer service centers; centrally managed real estate costs, including maintenance and utilities on all owned and leased buildings; credit and collection functions; and corporate overhead costs, such as finance, legal, human resources and external affairs. Pension and postretirement costs are also included to the extent that they relate to those employees.

Selling, general and administrative expenses in 2008 decreased due to the following:

- Lower other wireline support costs of $616 primarily due to higher advertising costs incurred in 2007 for brand advertising and re-branding related to the BellSouth acquisition.
- Lower net pension and postretirement cost of $231, primarily due to changes in our actuarial assumptions, including the increase of our discount rate from 6.00% to 6.50% (a decrease to expense) and favorable prior-year investment returns on plan assets resulting in a decrease in the recognition of net losses from prior years.
- Lower compensation expenses primarily reflecting shifts of force levels to cost of sales functions of $420 with related declines in medical and other benefits by $210.

Partially offsetting these decreases, selling, general and administrative expenses in 2008 increased due to:

- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $79.
- Higher provision for uncollectible accounts primarily related to our business and wholesale customers of $35.

In addition to the impact of the BellSouth acquisition, selling, general and administrative expenses in 2007 increased due to the following:

- Salary and wage merit increases and other bonus accruals of $102.
- Higher expenses of $96 in 2007 due to a 2006 change in our policy regarding the timing for earning vacation days, which reduced expense in 2006.
- Higher provision for uncollectible accounts of $80.

Partially offsetting these increases, selling, general and administrative expenses in 2007 decreased due to:

- Lower net pension and postretirement cost of $243, primarily due to changes in our actuarial assumptions, including the increase of our discount rate from 5.75% to 6.00% (a decrease to expense) and favorable investment returns on plan assets resulting in a decrease in the recognition of net losses from prior years.
- Lower employee levels, which decreased expenses, primarily salary and wages, by $222.
- Lower nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $148.

Depreciation and amortization expenses decreased $266, or 2%, in 2008. We had an increase of $3,734, or 38.6%, in 2007 primarily due to higher depreciable and amortizable asset bases as a result of the acquisition of BellSouth in 2006. The relative stability in 2008 is a result of decreasing intangible amortization partially offsetting increased depreciation resulting from capital additions.

Supplemental Information

Telephone, Wired Broadband and Video Connections Summary Our switched access lines and other services provided by our local exchange telephone subsidiaries at December 31, 2008, 2007 and 2006 are shown below and trends are addressed throughout this segment discussion.

				Percent Change	
(in 000s)	**2008**	2007	Pro Forma 2006[7]	**2008 vs. 2007**	2007 vs. 2006
Switched Access Lines[1]					
Retail Consumer	**30,614**	35,009	37,073	**(12.6)%**	(5.6)%
Retail Business[2]	**21,826**	22,811	23,484	**(4.3)**	(2.9)
Retail Subtotal[2]	**52,440**	57,820	60,557	**(9.3)**	(4.5)
Percent of total switched access lines	**94.3%**	93.9%	91.1%		
Sold to ATTC[2]	**140**	181	1,294	**(22.7)**	(86.0)
Sold to other CLECs[2,3]	**2,912**	3,330	4,288	**(12.6)**	(22.3)
Wholesale Subtotal[2]	**3,052**	3,511	5,582	**(13.1)**	(37.1)
Percent of total switched access lines	**5.5%**	5.7%	8.4%		
Payphone (Retail and Wholesale)[4]	**118**	251	330	**(53.0)**	(23.9)
Percent of total switched access lines	**0.2%**	0.4%	0.5%		
Total Switched Access Lines	**55,610**	61,582	66,469	**(9.7)**	(7.4)
Total Wired Broadband Connections[2,5]	**15,077**	14,156	12,170	**6.5**	16.3
Satellite service[6]	**2,190**	2,116	1,507	**3.5**	40.4
U-verse video	**1,045**	231	3	**—**	—
Video Connections	**3,235**	2,347	1,510	**37.8%**	55.4%

[1]Represents access lines served by AT&T's ILECs and affiliates.
[2]Prior period amounts restated to conform to current period reporting methodology.
[3]Competitive local exchange carriers (CLECs).
[4]Revenue from retail payphone lines is reported in the Other segment. We are in the process of ending our retail payphone operations.
[5]Total wired broadband connections include DSL, U-verse high-speed Internet access and satellite broadband.
[6]Satellite service includes connections under our agency and resale agreements.
[7]Amounts shown include BellSouth's access lines in service after the December 29, 2006 BellSouth acquisition.

Dollars in millions except per share amounts

Advertising & Publishing
Segment Results

				Percent Change	
	2008	2007	2006	**2008 vs. 2007**	2007 vs. 2006
Total Segment Operating Revenues	**$5,502**	$5,851	$3,685	**(6.0)%**	58.8%
Segment operating expenses					
Cost of sales	**1,716**	1,645	1,121	**4.3**	46.7
Selling, general and administrative	**1,282**	1,421	616	**(9.8)**	—
Depreciation and amortization	**789**	924	3	**(14.6)**	—
Total Segment Operating Expenses	**3,787**	3,990	1,740	**(5.1)**	—
Segment Operating Income	**1,715**	1,861	1,945	**(7.8)**	(4.3)
Equity in Net Income (Loss) of Affiliates	**—**	—	(17)	**—**	—
Segment Income	**$1,715**	$1,861	$1,928	**(7.8)%**	(3.5)%

Accounting Impacts From the BellSouth Acquisition
FAS 141 requires that BellSouth deferred revenue and expenses from directories published during the 12-month period ending with the December 29, 2006 acquisition date not be included in our consolidated results. However, for management reporting purposes we continued to amortize these balances over the life of the directory (typically 12 months). Thus, for segment disclosure purposes, our advertising & publishing segment results included revenue of $964 and expenses of $308 in 2007. See Note 4 for a discussion of FAS 141.

Operating Results
Our advertising & publishing segment operating income margin was 31.2% in 2008, 31.8% in 2007 and 52.8% in 2006. The decrease in the segment operating income margin in 2008 was primarily the result of decreased operating revenues. The decrease in the segment operating income margin in 2007 was primarily due to the addition of BellSouth's operating results, including the amortization of BellSouth's customer lists acquired as a part of the acquisition.

Operating revenues decreased $349, or 6.0%, in 2008 largely driven by continuing declines in print revenue of $453 and lower sales agency revenue of approximately $113 due to the sale of the independent line of business segment of the L.M. Berry Company. This decrease was partially offset by increased Internet advertising revenue of $196. In 2007, operating revenues increased $2,166, or 58.8%, primarily due to the addition of BellSouth's operating results, which increased operating revenues approximately $2,220 in 2007. This increase was largely driven by print advertising revenue of $1,859 and Internet advertising revenue of $200.

Operating expenses decreased $203, or 5.1%, in 2008 largely driven by decreased depreciation and amortization of $135 resulting from use of an accelerated method of amortization for the customer list acquired as part of the BellSouth acquisition, and lower employee, professional and contract related expenses. These expense decreases were partially offset by increased YELLOWPAGES.COM expansion costs. In 2007, operating expenses increased $2,250 primarily due to the addition of BellSouth's operating results, which increased total operating expenses by approximately $2,110 in 2007.

Other
Segment Results

				Percent Change	
	2008	2007	2006	**2008 vs. 2007**	2007 vs. 2006
Total Segment Operating Revenues	**$2,043**	$2,229	$1,883	**(8.3)%**	18.4%
Total Segment Operating Expenses	**2,929**	2,040	1,764	**43.6**	15.6
Segment Operating Income (Loss)	**(886)**	189	119	**—**	58.8
Equity in Net Income of Affiliates	**813**	676	2,020	**20.3**	(66.5)
Segment Income (Loss)	**$ (73)**	$ 865	$2,139	**—**	(59.6)%

Our other segment operating results consist primarily of Sterling, customer information services (primarily operator services and payphone), corporate and other operations. Sterling provides business-integration software and services.

Operating revenues decreased $186, or 8.3%, in 2008 and increased $346, or 18.4%, in 2007. The decrease in 2008 is primarily due to reduced revenues from our operator services and our retail payphone operations. We are in the process of ending our retail payphone operations. The increase in 2007 is primarily due to the addition of BellSouth's other operations and increased operating revenue at Sterling partially offset by decreased revenues from our retail payphone operations.

Operating expenses increased $889, or 43.6%, in 2008 and $276, or 15.6%, in 2007. The increase in 2008 was primarily due to charges of $978 associated with our workforce reductions announced in 2008, primarily employees in non-customer-facing areas of the business as a result of the restructure of our operations from a collection of regional companies to a single national approach. This was partially offset by reduction in reserves held at our captive insurance company and by decreased operating expenses from our operator services and retail payphone operations. The increase in 2007 was primarily due to the addition of BellSouth's other operations and increased operating expenses at Sterling partially offset by decreased expense from our retail payphone operations.

Prior to the December 29, 2006 close of the BellSouth acquisition, our other segment included our 60% proportionate share of AT&T Mobility results as equity in net income of affiliates. As a result of the BellSouth acquisition, we own 100% of AT&T Mobility and its results for the final two days of 2006 and for the year 2007 have been excluded from equity in net income of affiliates in this segment and on our consolidated statements of income.

Our other segment also includes our equity investments in international companies, the income from which we report as equity in net income of affiliates. Our earnings from foreign affiliates are sensitive to exchange-rate changes in the value of the respective local currencies. Our foreign investments are recorded under GAAP, which include adjustments for the purchase method of accounting and exclude certain adjustments required for local reporting in specific countries. Our equity in net income of affiliates by major investment is listed below:

	2008	2007	2006
América Móvil	**$469**	$381	$ 274
Telmex & Telmex Internacional	**324**	265	222
AT&T Mobility	**—**	—	1,508
Other	**20**	30	16
Other Segment Equity in Net Income of Affiliates	**$813**	$676	$2,020

Equity in net income of affiliates increased $137 in 2008. Equity in net income in América Móvil increased $88 in 2008 primarily due to improved operating results. Equity in net income in Telmex and Telmex Internacional increased $59 reflecting lower depreciation and tax expenses, and improved operating results.

OPERATING ENVIRONMENT AND TRENDS OF THE BUSINESS

2009 Revenue Trends We expect a challenging operating environment in 2009 due to the continuing economic recession, increasing competition and changes at the federal government level. Despite this environment, we expect a modest expansion of our operating revenues in 2009 compared to 2008, reflecting continuing growth in our wireless and broadband/data services. We expect our primary driver of growth to be wireless, especially in sales and increased use of advanced handsets including the Apple iPhone 3G, and that all our major customer categories will continue to increase their use of Internet-based broadband/data services. We expect revenue growth will also reflect the increased information and technology services to be provided under our agreements with IBM. We expect continuing declines in traditional access lines but offsets in growth in broadband and video services. We expect solid growth in broadband revenues as customers continue to choose higher-speed services. We expect to continue to expand our U-verse service offerings in 2009.

2009 Expense Trends Our major merger integration projects are now largely completed. However, given our expected challenging operating environment for 2009, we will continue to focus intensely on cost-control measures. We expect our operating income margin to be stable excluding pressure from our pension and retiree benefit costs. We expect our pension and retiree benefit costs to increase significantly due to our accounting policy for handling substantial investment losses in 2008 on our retirement plans' assets (see "Significant Accounting Policies and Estimates"). We do not expect significant pension funding requirements in 2009. Expenses related to growth initiatives (see "Expected Growth Areas") will apply some pressure to our operating income margin.

Market Conditions During 2008, the securities and mortgage markets and the banking system in general experienced significant declines in value and liquidity. The U.S. Congress, the U.S. Treasury Department, the Federal Reserve System and various other regulators have worked together to adopt plans to restore liquidity and stability to the securities, mortgage and banking systems. Although we have issued short-term and long-term debt during this economic decline, the U.S. government has provided capital to financial institutions and has enabled access to short-term borrowings for companies with high credit ratings. We are not yet able to determine the outcome of these plans.

Included on our consolidated balance sheets are assets held by benefit plans for the payment of future benefits. The losses associated with the securities markets declines during 2008 are not expected to have an impact on the ability of our benefit plans to pay benefits. We do not expect to make significant funding contributions to our pension plans in 2009. However, because our pension plans are subject to funding requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA), a continued weakness in the markets could require us to make contributions to the pension plans in order to maintain minimum funding requirements as established by ERISA. In addition, our policy on recognizing losses on investments in the pension and other postretirement plans will accelerate the recognition of losses in 2009 earnings (see "Significant Accounting Policies and Estimates").

The ongoing weaknesses in the general economy and in the securities, credit and mortgage markets are also affecting portions of our customer and supplier bases although, at this time, we are unable to quantify the effects. We are seeing lower demand for our services from residential wireline customers. Although business revenues remained relatively stable this past year, we experienced some softening of demand late in 2008 for usage-based services, such as voice and transport. Our print directory revenues also declined during 2008 as the economy continued to weaken. Some of our suppliers also are experiencing increased financial and operating costs and one large telecom equipment supplier recently declared bankruptcy. As of year-end, these negative trends had been offset by continued growth in our wireless business. Our wireless growth reflects both an increased demand for advanced services, as evidenced by our successful launch of the iPhone 3G and other advanced devices, and increased sales of other advanced handsets, as well as a shift in demand from our traditional wireline services. Should the economy continue to deteriorate, we likely will experience pressure on pricing and margins as we compete for both wireline and wireless customers who will have less discretionary income. We also may experience difficulty purchasing equipment in a timely manner or maintaining and replacing warranteed equipment from our suppliers.

OPERATING ENVIRONMENT OVERVIEW

AT&T subsidiaries operating within the U.S. are subject to federal and state regulatory authorities. AT&T subsidiaries operating outside the U.S. are subject to the jurisdiction of national and supranational regulatory authorities in the markets where service is provided, and regulation is generally limited to operational licensing authority for the provision of services to enterprise customers.

In the Telecommunications Act of 1996 (Telecom Act), Congress established a national policy framework intended to bring the benefits of competition and investment in advanced telecommunications facilities and services to all Americans by opening all telecommunications markets to competition and reducing or eliminating regulatory burdens that harm consumer welfare. However, since the Telecom Act was passed, the Federal Communications Commission (FCC) and some state regulatory commissions have maintained certain regulatory requirements that were imposed decades ago on our traditional wireline subsidiaries when they operated as legal monopolies. Where appropriate, we are pursuing additional legislative and regulatory measures to reduce regulatory burdens that inhibit our ability to compete more effectively and offer services wanted and needed by our customers. For example, we are supporting regulatory and legislative efforts that would offer new video entrants a streamlined process for bringing new video services to market and for offering more timely competition to traditional cable television providers. In addition, states representing a majority of our local service access lines have adopted legislation that enables new video entrants to acquire a single statewide or state-approved franchise (as opposed to the need to acquire hundreds or even thousands of municipal-approved franchises) to offer competitive video services. We also are supporting efforts to update and improve regulatory treatment for retail services. Passage of legislation is uncertain and depends on many factors.

Our wireless operations operate in robust competitive markets, but are likewise subject to substantial governmental regulation. Wireless communications providers must be licensed by the FCC to provide communications services at specified spectrum frequencies within specified geographic areas and must comply with the rules and policies governing the use of the spectrum as adopted by the FCC. While wireless communications providers' prices and service offerings are generally not subject to state regulation, an increasing number of states are attempting to regulate or legislate various aspects of wireless services, such as in the area of consumer protection. Additionally, we have noted our opposition to proposals to impose extreme versions of "net neutrality" open access regulation on wireless providers. It is widely recognized that the wireless industry in the United States is characterized by innovation, differentiation, declining prices and extensive competition among handset manufacturers, service providers and applications and that additional broadband regulation and new wholesale requirements are unnecessary and counterproductive and will discourage new investment and may be appropriate only in the case of market failure.

Expected Growth Areas

We expect our wireless services and data wireline products to remain the most significant portion of our business and have also discussed trends affecting the segments in which we report results for these products (see "Wireless Segment Results" and "Wireline Segment Results"). Over the next few years we expect an increasing percentage of our growth to come from: (1) our wireless service and (2) data/broadband, through existing and new services. We expect that our previous acquisitions will enable us to strengthen the reach and sophistication of our network facilities, increase our large-business customer base and enhance the opportunity to market wireless services to that customer base. Whether, or the extent to which, growth in these areas will offset declines in other areas of our business is not known.

Wireless Wireless is our fastest-growing revenue stream and we expect to deliver continued revenue growth in the coming years. We believe that we are in a growth period of wireless data usage and that there are substantial opportunities available for next-generation converged services that combine wireless, broadband, voice and video.

Our Universal Mobile Telecommunications System/ High-Speed Downlink Packet Access 3G network technology covers most major metropolitan areas of the U.S. This technology provides superior speeds for data and video services, and it offers operating efficiencies by using the same spectrum and infrastructure for voice and data on an IP-based platform. Our wireless networks also rely on digital transmission technologies known as GSM, General Packet Radio Services and Enhanced Data Rates for GSM Evolution for data communications. As of December 31, 2008, we served 77 million customers.

As the wireless industry continues to mature, we believe that future wireless growth will become increasingly dependent on our ability to offer innovative services that will encourage existing customers to upgrade their services, either by adding new types of services, such as data enhancements, or through increased use of existing services, such as through equipment upgrades. These innovative services should attract customers from other providers, as well as minimize customer churn. We intend to accomplish these goals by continuing to expand our network coverage, improve our network quality and offer a broad array of products and services, including exclusive devices such as the Apple iPhone 3G and free mobile-to-mobile calling among our wireless customers. Minimizing customer churn is critical to our ability to maximize revenue growth and to maintain and improve our operating margins.

U-verse Services We are continuing to expand our deployment of U-verse high-speed broadband and TV services. As of December 31, 2008, we have passed approximately 17 million living units (constructed housing units as well as platted housing lots) and are marketing the services to almost 65 percent of those units. Our deployment strategy is to enter each new area on a limited basis in order to ensure that all operating and back-office systems are functioning successfully and then expand within each as we continue to monitor these systems. In these expansions, we expect to continue to use contracted outside labor in addition to our employees as installers; our rate of expansion will be slowed if we cannot hire and train an adequate number of qualified contractors and technicians to keep pace with customer demand or if we cannot obtain all required local building permits in a timely fashion. We also continue to work with our vendors on improving, in a timely manner, the requisite hardware and software technology. Our deployment plans could be delayed if we do not receive required equipment and software on schedule.

We believe that our U-verse TV service is subject to federal oversight as a "video service" under the Federal Communications Act. However, some cable providers and municipalities have claimed that certain IP services should be treated as a traditional cable service and therefore subject to the applicable state and local cable regulation. Certain municipalities have delayed our request or have refused us permission to use our existing right-of-ways to deploy or activate our U-verse-related services and products, resulting in litigation. Pending negotiations and current or threatened litigation involving municipalities could delay our deployment plans in those areas. In July 2008, the U.S. District Court for Connecticut affirmed its October 2007 ruling that AT&T's U-verse TV service is a cable service in Connecticut. We have appealed that decision on the basis that state legislation rendered the case moot. If courts having jurisdiction where we have significant deployments of our U-verse services were to decide that federal, state and/or local cable regulation were applicable to our U-verse services, it could have a material adverse effect on the cost, timing and extent of our deployment plans.

REGULATORY DEVELOPMENTS

Set forth below is a summary of the most significant developments in our regulatory environment during 2008. While these issues, for the most part, apply only to certain subsidiaries in our wireline segment, the words "we," "AT&T" and "our" are used to simplify the discussion. The following discussions are intended as a condensed summary of the issues rather than as a precise legal description of all of these specific issues.

International Regulation Our subsidiaries operating outside the U.S. are subject to the jurisdiction of regulatory authorities in the market where service is provided. Our licensing, compliance and advocacy initiatives in foreign countries primarily enable the provision of enterprise (i.e., large business) services. AT&T is engaged in multiple efforts with foreign regulators to open markets to competition, reduce network costs and increase our scope of fully authorized network services and products.

Federal Regulation A summary of significant 2008 Federal regulatory developments follows.

Wireless

Wireless Spectrum Auction In March 2008, the FCC announced that we were the winning bidder of 227 B Block 700 MHz Band wireless spectrum licenses in an auction conducted by the FCC. Accordingly, in April 2008, we paid the FCC $6,136, which was in addition to the $500 deposit that we provided to the FCC at the start of the auction. This purchase was funded using cash from operations and debt. In April 2008, we submitted our license application to the FCC, requesting that the FCC grant the wireless licenses on which we were the high bidder. The FCC granted the licenses on January 6, 2009. We will use this spectrum as we build out our network for next generation wireless services.

Order on Recommendations of the Hurricane Katrina Panel In October 2007, the FCC issued an order that was intended to improve the reliability, interoperability and recovery of telecommunications in future disasters. The order required carriers to maintain backup power at certain points in the network, such as cell sites and remote terminals. In February 2008, the D.C. Circuit granted a stay of the effective date of the Katrina Order's backup power rules, pending review of a filed appeal. In November 2008, the FCC asked the court to dismiss the appeal as moot and further indicated that it would begin a new rulemaking proceeding to establish revised backup power rules. To date, the court has not acted on the FCC's request.

E911 Order In September 2007, the FCC adopted an order (the E911 Order) that would have substantially increased accuracy requirements in connection with providing the location of a wireless caller to dispatchers of 911 emergency services. Compliance with interim accuracy benchmarks would have been required in March 2009.

Under FCC rules, carriers are required to attempt to deliver location data to Public Safety Answering Points (PSAPs) when callers dial 911. We use a network-based location solution that employs triangulation to estimate the location of the caller. Location data for this network-based solution must be accurate within 300 meters on 95 percent of all calls and within 100 meters on 67 percent of all calls. The current rules permit these percentages to be calculated based on all calls, network-wide, for purposes of measuring location accuracy. The E911 Order would have required wireless carriers to achieve E911 location accuracy measured in each of the local areas served by the approximately 6,000 PSAPs across the country. Carriers would have had until September 2012 to achieve PSAP-level accuracy, and would have had to demonstrate compliance with certain incremental location accuracy benchmarks in 2009 and 2010. The PSAP-level accuracy requirement in the E911 Order was not attainable throughout our wireless network using currently available commercial technology.

In March 2008, the United States Court of Appeals for the D.C. Circuit (Court of Appeals) granted motions filed by AT&T and other carriers seeking a stay of the E911 Order pending a ruling on the merits of the appeals of that order. Subsequently, the FCC filed a motion with the Court of Appeals asking that the E911 Order be vacated and remanded. The Court of Appeals vacated the E911 Order in September 2008. As of the date of this report, discussions are continuing between the FCC, wireless carriers, and the public safety community as to what steps should be taken regarding improved E911 accuracy.

Wireless Universal Service AT&T Mobility is currently a Competitive Eligible Telecommunications Carrier (CETC) for purposes of receiving federal universal service support in several states. To maintain these designations, the state must certify that the carrier is entitled to receive the funds for the subsequent calendar year based on federal and applicable state CETC requirements. We are current on our certifications and have a process to review these requirements on an annual basis. In May 2008, the FCC adopted an Order capping high-cost universal service support received by CETCs — predominantly wireless carriers — at a statewide level. The state-specific cap will be set based on the amount of support that CETCs in that state were eligible to receive in March 2008 on an annualized basis. Notably, while AT&T previously consented to a voluntary cap on its receipt of federal universal service support as of June 30, 2007 in order to obtain approval for the acquisition of Dobson, this commitment was superseded by the industry-wide CETC cap adopted in the May 2008 Order. The industry-wide cap was implemented in the third quarter of 2008. AT&T Mobility received approximately $211 million in federal high-cost support in 2008.

State Regulation A summary of significant 2008 state regulatory developments follows.

Video Service Legislation A number of states in which we operate have adopted legislation or issued clarifying opinions that will make it easier for telecommunications companies to offer video service.

California High Cost Fund In June 2006, the California Public Utilities Commission (CPUC) opened a rulemaking to review the California High Cost Fund B (CHCF-B). The CHCF-B program was established in 1996 and was designed to support universal service goals by ensuring that basic telephone service remains affordable in high-cost areas within the service territories of the state's major incumbent local exchange carriers. In September 2007, the CPUC adopted a decision that changed how the CHCF-B is calculated. We estimate the change will reduce our payments from the CHCF-B by approximately $100 in 2009 compared to 2008 payments. In September 2008, the CPUC adopted a related decision, which permits but does not require, increases to basic rates of prescribed amounts over a two-year phase-in period beginning January 1, 2009. This two-year transition period concludes with full pricing flexibility for basic residential service starting January 1, 2011.

COMPETITION

Competition continues to increase for telecommunications and information services. Technological advances have expanded the types and uses of services and products available. In addition, lack of or a reduced level of regulation of comparable alternatives (e.g., cable, wireless and VoIP providers) has lowered costs for these alternative communications service providers. As a result, we face heightened competition as well as some new opportunities in significant portions of our business.

Wireless

We face substantial and increasing competition in all aspects of our wireless business. Under current FCC rules, six or more PCS licensees, two cellular licensees and one or more enhanced specialized mobile radio licensees may operate in each of our service areas, which results in the potential presence of multiple competitors. Our competitors are principally three national (Verizon Wireless, Sprint Nextel Corp. and T-Mobile) and a larger number of regional providers of cellular, PCS and other wireless communications services. More than 95% of the U.S. population lives in areas with three mobile telephone operators and more than half the population lives in areas with at least five competing carriers.

We may experience significant competition from companies that provide similar services using other communications technologies and services. While some of these technologies and services are now operational, others are being developed or may be developed in the future. We compete for customers based principally on price, service offerings, call quality, coverage area and customer service.

We were a winning bidder in the FCC 700 MHz spectrum auctions that began in January 2008, and in 2008, we purchased additional spectrum licenses covering 196 million people in the 700 MHz frequency band. The availability of this additional spectrum from the auctions could increase the effectiveness of existing competition, or result in new entrants in the wireless arena.

Wireline

Our wireline subsidiaries expect continued competitive pressure in 2009 from multiple providers, including wireless, cable and other VoIP providers, interexchange carriers and resellers. In addition, economic pressures are forcing customers to terminate their traditional local wireline service and substitute wireless and Internet-based services, intensifying a pre-existing trend toward wireless and Internet use. At this time, we are unable to quantify the effect of competition on the industry as a whole, or financially on this segment. However, we expect both losses of revenue share in local service and gains resulting from business initiatives, especially in the area of bundling of products and services, including wireless and video, large-business data services and broadband. In most markets, we compete with large cable companies, such as Comcast Corporation, Cox Communications, Inc. and Time Warner Inc., for local, high-speed Internet and video services customers and other smaller telecommunications companies for both long-distance and local services customers.

Our wireline subsidiaries generally remain subject to regulation by state regulatory commissions for intrastate services and by the FCC for interstate services. In contrast, our competitors are often subject to less or no regulation in providing comparable voice and data services or the extent of regulation is in dispute. Under the Telecom Act, companies seeking to interconnect to our wireline subsidiaries' networks and exchange local calls enter into interconnection agreements with us. Any unresolved issues in negotiating those agreements are subject to arbitration before the appropriate state commission. These agreements (whether fully agreed-upon or arbitrated) are then subject to review and approval by the appropriate state commission.

Recently, in a number of the states in which we operate as an ILEC, state legislatures or the state public utility commissions have concluded that the voice telecommunications market is competitive and have allowed for greater pricing flexibility for non-basic residential retail services, including bundles, promotions and new products and services. While it has been a number of years since we have been allowed to raise local service rates in certain states, some of these state actions have been challenged by certain parties and are pending court review.

In addition to these rates and service regulations noted above, our wireline subsidiaries (excluding rural carrier affiliates) operate under state-specific elective "price-cap regulation" for retail services (also referred to as "alternative regulation") that was either legislatively enacted or authorized by the appropriate state regulatory commission. Under price-cap regulation, price caps are set for regulated services and are not tied to the cost of providing the services or to rate-of-return requirements. Price-cap rates may be subject to or eligible for annual decreases or increases and also may be eligible for deregulation or greater pricing flexibility if the associated service is deemed competitive under some state regulatory commission rules. Minimum customer service standards may also be imposed and payments required if we fail to meet the standards.

We continue to lose access lines due to competitors (e.g., wireless, cable and VoIP providers) who can provide comparable services at lower prices because they are not subject to traditional telephone industry regulation (or the extent of regulation is in dispute) and consequently have lower cost structures. In response to these competitive pressures, for several years we have utilized a bundling strategy that rewards customers who consolidate their services (e.g., local and long-distance telephone, DSL, wireless and video) with us. We continue to focus on bundling wireline and wireless services, including combined packages of minutes and video service through our AT&T U-verse service and our relationships with satellite television providers. We will continue to develop innovative products that capitalize on our expanding fiber network.

Additionally, we provide local, domestic intrastate and interstate, international wholesale networking capacity and switched services to other service providers, primarily large Internet Service Providers using the largest class of nationwide Internet networks (Internet backbone), wireless carriers, CLECs, regional phone ILECs, cable companies and systems integrators. These services are subject to additional competitive pressures from the development of new technologies and the increased availability of domestic and international transmission capacity. The introduction of new products and service offerings and increasing satellite, wireless, fiber-optic and cable transmission capacity for services similar to those provided by us continues to provide competitive pressures. We face a number of international competitors, including Equant, British Telecom and SingTel; as well as competition from a number of large systems integrators, such as Electronic Data Systems.

Advertising & Publishing

Our advertising & publishing subsidiaries face competition from approximately 100 publishers of printed directories in their operating areas. Competition also exists from other advertising media, including newspapers, radio, television and direct-mail providers, as well as from directories offered over the Internet. Through our wholly-owned subsidiary, YPC, we compete with other providers of Internet-based advertising and local search.

ACCOUNTING POLICIES AND STANDARDS

Significant Accounting Policies and Estimates Because of the size of the financial statement line items they relate to, some of our accounting policies and estimates have a more significant impact on our financial statements than others. The policies below are presented in the order in which the topics appear in our consolidated statements of income.

Allowance for Uncollectibles We maintain an allowance for doubtful accounts for estimated losses that result from the failure of our customers to make required payments. When determining the allowance, we consider the probability of recoverability based on past experience, taking into account current collection trends as well as general economic factors, including bankruptcy rates. Credit risks are assessed based on historical write-offs, net of recoveries, and an analysis of the aged accounts receivable balances with reserves generally increasing as the receivable ages. Accounts receivable may be fully reserved for when specific collection issues are known to exist, such as pending bankruptcy or catastrophes. The analysis of receivables is performed monthly and the bad-debt allowances are adjusted accordingly. A 10% change in the amounts estimated to be uncollectible would result in a change in uncollectible expense of approximately $130.

Pension and Postretirement Benefits Our actuarial estimates of retiree benefit expense and the associated significant weighted-average assumptions are discussed in Note 11. One of the most significant of these assumptions is the return on assets assumption, which was 8.50% for the year ended December 31, 2008. In setting the long-term assumed rate of return, management considers capital markets future expectations and the asset mix of the plans' investments. The actual long-term return can, in relatively stable markets, also serve as a factor in determining future expectations. However, the dramatic adverse market conditions in 2008 have skewed the calculation of the long-term actual return; the actual 10-year return was 4.21% through 2008 compared with 9.18% through 2007. The severity of the 2008 losses will make the 10-year actual return less of a relevant factor in management's evaluation of future expectations. Based on future expectations and the plans' asset mix, management has left unchanged the long-term assumed rate of return for 2009. If all other factors were to remain unchanged, we expect that a 1.0% decrease in the assumed long-term rate of return would cause 2009 combined pension and postretirement cost to increase $650 over 2008. Under GAAP, the expected long-term rate of return is calculated on the market-related value of assets (MRVA). GAAP requires that actual gains and losses on pension and postretirement plan assets be recognized in the MRVA equally over a period of up to five years. We use a methodology, allowed under GAAP, under which we hold the MRVA to within 20% of the actual fair value of plan assets, which can have the effect of accelerating the recognition of excess actual gains and losses into the MRVA in less than five years. We expect that use of this policy will increase precapitalization pension and postretirement costs by $1,577 in 2009. This methodology did not have a significant additional effect on our 2008, 2007 or 2006 combined net pension and postretirement costs. Note 11 also discusses the effects of certain changes in assumptions related to medical trend rates on retiree health care costs.

Depreciation Our depreciation of assets, including use of composite group depreciation and estimates of useful lives, is described in Notes 1 and 5. We assign useful lives based on periodic studies of actual asset lives. Changes in those lives with significant impact on the financial statements must be disclosed, but no such changes have occurred in the three years ended December 31, 2008. However, if all other factors were to remain unchanged, we expect that a one-year increase in the useful lives of the largest categories of our plant in service (which accounts for more than three-fourths of our total plant in service) would result in a decrease of approximately $2,160 in our 2009 depreciation expense and that a one-year decrease would result in an increase of approximately $3,390 in our 2009 depreciation expense.

Asset Valuations and Impairments We account for acquisitions using the purchase method as required by FAS 141. Under FAS 141, we allocate the purchase price to the assets acquired and liabilities assumed based on their estimated fair values. The estimated fair values of intangible assets acquired are based on the expected discounted cash flows of the identified customer relationships, patents, tradenames and licenses. In determining the future cash flows, we consider demand, competition and other economic factors.

Customer relationships, which are finite-lived intangible assets, are primarily amortized using the sum-of-the-months-digits method of amortization over the period in which those relationships are expected to contribute to our future cash flows. The sum-of-the-months-digits method is a process of allocation, not of valuation, and reflects our belief that we expect greater revenue generation from these customer relationships during the earlier years of their lives. Alternatively, we could have chosen to amortize customer relationships using the straight-line method, which would allocate the cost equally over the amortization period. Amortization of other intangibles, including patents and amortizable tradenames, is determined using the straight-line method of amortization over the expected remaining useful lives. We do not amortize indefinite-lived intangibles, such as wireless FCC licenses or certain tradenames (see Note 6).

Goodwill and wireless FCC licenses are not amortized but tested annually for impairment in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (FAS 142). We review other long-lived assets for impairment under Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" whenever events or circumstances indicate that the carrying amount may not be recoverable over the remaining life of the asset or asset group. In order to determine that the asset is recoverable, we verify that the expected future cash flows directly related to that asset exceed its fair value, which is based on the undiscounted cash flows. The discounted cash flow calculation uses various assumptions and estimates regarding future revenue, expense and cash flows projections over the estimated remaining useful life of the asset.

Cost investments are evaluated to determine whether mark-to-market declines are temporary and reflected in other comprehensive income, or other than temporary and recorded as an expense in the income statement. This evaluation is based on the length of time and the severity of decline in the investment's value. At the end of 2008, we concluded the severity of decline in the latter half of 2008 had led to an other than temporary decline in the value of assets contained in an independently managed trust for certain BellSouth employee benefits (see Note 11).

Income Taxes Our estimates of income taxes and the significant items giving rise to the deferred assets and liabilities are shown in Note 10 and reflect our assessment of actual future taxes to be paid on items reflected in the financial statements, giving consideration to both timing and probability of these estimates. Actual income taxes could vary from these estimates due to future changes in income tax law or the final review of our tax returns by federal, state or foreign tax authorities.

In 2007, we adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) and began accounting for uncertain tax positions under the provisions of FIN 48. As required by FIN 48, we use our judgment to determine whether it is more likely than not that we will sustain positions that we have taken on tax returns and, if so, the amount of benefit to initially recognize within our financial statements. We regularly review our uncertain tax positions and adjust our unrecognized tax benefits in light of changes in facts and circumstances, such as changes in tax law, interactions with taxing authorities and developments in case law. These adjustments to our unrecognized tax benefits may affect our income tax expense. Settlement of uncertain tax positions may require use of our cash.

New Accounting Standards

FAS 161 In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" (FAS 161). FAS 161 requires enhanced disclosures about an entity's derivative and hedging activities to improve the transparency of financial reporting. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. FAS 161 is expected to increase quarterly and annual disclosures but will not have an impact on our financial position and results of operations.

FSP 157-3 In October 2008, the FASB issued FASB Staff Position 157-3, "Determining the Fair Value of a Financial Asset When the Market of that Asset is not Active" (FSP 157-3). FSP 157-3 provides an example that clarifies and reiterates certain provisions of the existing fair value standard, including basing fair value on orderly transactions and usage of management and broker inputs. FSP 157-3 is effective immediately but is not expected to have a material impact on our financial position or results of operations.

FSP FAS 142-3 In April 2008, the FASB issued FASB Staff Position FAS 142-3, "Determination of the Useful Life of Intangible Assets" (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, "Goodwill and Other Intangible Assets." FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are currently evaluating the impact that FSP FAS 142-3 will have on our accounting for intangible assets.

FSP FAS 132(R)-1 In December 2008, the FASB issued FASB Staff Position FAS 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets" (FSP FAS 132(R)-1). FSP FAS 132(R)-1 amends FASB Statement No. 132(R), "Employers' Disclosures about Pensions and Other Postretirement Benefit" (FAS 132(R)). This FASB Staff Position replaces the requirement to disclose the percentage of fair value of total plan assets with a requirement to disclose the fair value of each major asset category. It also amends FASB Statement No. 157, "Fair Value Measurements" (FAS 157), to clarify that defined benefit pension or other postretirement plan assets are not subject to FAS 157's disclosure requirements. FSP FAS 132(R)-1 is effective for fiscal years ending after December 2009. This FSP will significantly increase the amount of disclosures for plan assets in our 2009 Annual Report.

EITF 08-6 In November 2008, the Emerging Issues Task Force (EITF) reached a consensus on EITF 08-6, "Equity Method Investment Accounting Considerations." EITF 08-6 provides guidance on the application of the equity method. It states equity-method investments should be recognized using a cost accumulation model. Also, it requires that equity method investments as a whole be assessed for other-than-temporary impairment in accordance with Accounting Principles Board Opinion No. 18. EITF 08-6 is effective on a prospective basis for transactions in an investee's shares occurring or impairments recognized in fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. This EITF will not have a material impact on our financial position and results of operations.

EITF 08-7 In November 2008, the EITF reached a consensus on EITF 08-7, "Accounting for Defensive Intangible Assets." EITF 08-7 provides that intangible assets that an acquirer intends to use as defensive assets, intangible assets acquired in a business combination or an asset acquisition that an entity does not intend to actively use but does intend to prevent others from using, are a separate unit of account from the existing intangible assets of the acquirer. It also states that a defensive intangible asset should be amortized over the period that the fair value of the defensive intangible asset diminishes. EITF 08-7 is effective on a prospective basis for transactions occurring in fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. This EITF will require AT&T to recognize at fair value certain assets associated with trademarks for the non-surviving companies of acquisitions and amortize these trademarks over the period they are expected to contribute directly or indirectly to the entity's future cash flows.

OTHER BUSINESS MATTERS

Retiree Phone Concession Litigation In May 2005, we were served with a purported class action in U.S. District Court, Western District of Texas (Stoffels v. SBC Communications Inc.), in which the plaintiffs, who are retirees of Pacific Bell Telephone Company, Southwestern Bell and Ameritech, contend that the telephone concession provided by the company is, in essence, a "defined benefit plan" within the meaning of the Employee Retirement Income Security Act of 1974, as amended (ERISA). In October 2006, the Court certified two classes. The issue of whether the concession is an ERISA pension plan was tried before the judge in November 2007. In May 2008, the court ruled that the concession was an ERISA pension plan. We asked the court to certify this ruling for interlocutory appeal and in August 2008, the court denied our request. A trial on the appropriate remedy has been set for December 7, 2009. We believe that an adverse outcome having a material effect on our financial statements in this case is unlikely, but will continue to evaluate the potential impact of this suit on our financial results as it progresses.

NSA Litigation There are 24 pending lawsuits that allege that we and other telecommunications carriers unlawfully provided assistance to the National Security Agency (NSA) in connection with intelligence activities that were initiated following the events of September 11, 2001. In the first filed case, Hepting et al v. AT&T Corp., AT&T Inc. and Does 1-20, a purported class action filed in U.S. District Court in the Northern District of California, plaintiffs allege that the defendants have disclosed and are currently disclosing to the U.S. Government content and call records concerning communications to which plaintiffs were a party. Plaintiffs seek damages, a declaratory judgment, and injunctive relief for violations of the First and Fourth Amendments to the United States Constitution, the Foreign Intelligence Surveillance Act, the Electronic Communications Privacy Act, and other federal and California statutes. We filed a motion to dismiss the complaint. The United States asserted the "state secrets privilege" and related statutory privileges and also filed a motion asking the court to dismiss the complaint. The court denied the motions to dismiss of both parties.

We and the U.S. Government filed interlocutory appeals. The case was argued before a panel of the U.S. Court of Appeals for the Ninth Circuit in August 2007. In August 2008, the court remanded the case to the district court without deciding the issue in light of the passage of the FISA Amendments Act discussed below.

In July 2008, the President signed into law, the FISA (Foreign Intelligence Surveillance Act) Amendments Act of 2008 (the Act), a provision of which addresses the allegations in these pending lawsuits (immunity provision). The immunity provision requires the pending lawsuits to be dismissed if the Attorney General certifies to the court either that the alleged assistance was undertaken by court order, certification, directive, or written request or that the telecom entity did not provide the alleged assistance. In September 2008, the Attorney General filed his certification and asked the court to dismiss all of the lawsuits pending against the telecommunications companies. In October 2008, the plaintiffs filed an opposition to the certification and motion to dismiss arguing that the Act is unconstitutional and, alternatively, that the Government failed to meet its burden of justifying dismissal. The court heard argument on the Government's motion to dismiss on December 2, 2008. We are awaiting the court's decision. We believe that the immunity provision is constitutional, that the Government has met its burden of proof, and that the lawsuits pending against us will eventually be dismissed.

In addition, a lawsuit seeking to enjoin the immunity provision's application on grounds that it is unconstitutional was filed the day after the Act was signed by the President. That case has been referred to the Joint Panel on Multidistrict Litigation (MDL), which has conditionally transferred the case to the Northern District of California, the court referred to above that is considering the Attorney General's certification and motion to dismiss. On January 6, 2009, the transfer order was filed in the MDL docket, giving the Northern District of California jurisdiction over the case.

Management believes these actions are without merit and intends to defend these matters vigorously.

Prepaid Calling Card Patent Litigation In September 2007, a jury in Texas found that ATTC willfully infringed two patents owned by TGIP Inc. (TGIP) relating to point-of-sale prepaid cards sold by ATTC and awarded TGIP $156 in damages. (TGIP Inc. v. AT&T Corp. et al., U.S. District Court for the Eastern District of Texas). AT&T filed a motion requesting that the court overturn the jury's verdict as a matter of law. In October 2007, the court overturned the jury's finding of infringement, the jury's $156 award of damages and the jury's finding of willfulness. TGIP appealed the court's decision. In April 2008, the parties settled the litigation resulting in no additional expense accrual.

Broadcom Patent Dispute A number of our handsets, as well as those provided by other wireless carriers, were subject to a patent dispute at the U.S. International Trade Commission (ITC) between Broadcom Corporation and Qualcomm Incorporated (Qualcomm). In October 2008, the Court of Appeals for the Federal Circuit vacated and remanded the ITC's finding that Qualcomm had infringed a Broadcom patent and vacated the ITC's limited exclusion order applicable to certain handsets containing Qualcomm technology. The court held that the ITC did not have authority to issue a limited exclusion order affecting handset suppliers and retailers, such as AT&T, unless those parties were also named in the lawsuit. While this ruling would allow us to continue to sell to our customers handsets using the disputed Qualcomm chips, we do not currently offer any such handsets.

DIRECTV Agreement In September 2008, we announced an agreement to market and sell DIRECTV's service as a co-branded satellite television service after January 31, 2009. We did offer, market and sell co-branded AT&T | DISH Network services through January 31, 2009. After that date, existing AT&T | DISH Network customers will continue to receive DISH Network service under the existing AT&T | DISH Network agreement.

Centennial Communications Acquisition In November 2008, we agreed to acquire Centennial Communications, Corp., a regional provider of wireless and wired communications services with 1.1 million customers, for $944 plus net debt of approximately $2,000. The acquisition is subject to regulatory approval and is expected to close by mid-year 2009.

Environmental We are subject from time to time to judicial and administrative proceedings brought by various governmental authorities under federal, state or local environmental laws. Although we are required to reference in our Forms 10-Q and 10-K any of these proceedings that could result in monetary sanctions (exclusive of interest and costs) of one hundred thousand dollars or more, we do not believe that any of them currently pending will have a material adverse effect on our results of operations.

LIQUIDITY AND CAPITAL RESOURCES

We had $1,792 in cash and cash equivalents available at December 31, 2008. Cash and cash equivalents included cash of $958 and money market funds and other cash equivalents of $834. Cash and cash equivalents decreased $178 since December 31, 2007. During 2008, cash inflow was primarily provided by cash receipts from operations, the issuance of long-term debt, net cash received from dispositions of non-strategic real estate and the sale of marketable securities and other assets. These inflows were offset by cash used to meet the needs of the business including, but not limited to, payment of operating expenses, funding capital expenditures, acquisition of wireless spectrum, repurchase of common shares, repayment of debt, dividends to stockholders and payment of interest on debt. We discuss many of these factors in detail below.

Cash Provided by or Used in Operating Activities

During 2008, cash provided by operating activities was $33,656 compared to $34,242 in 2007. Operating cash flows decreased primarily due to increased tax payments of $1,294 partially offset by improvement in operating income excluding depreciation. During 2008, tax payments were higher primarily due to increased income. The timing of cash payments for income taxes, which is governed by the IRS and other taxing jurisdictions, will differ from the timing of recording tax expense and deferred income taxes, which are reported in accordance with GAAP.

During 2007, our primary source of funds was cash from operating activities of $34,242 compared to $15,688 in 2006. Operating cash flows increased primarily due to an increase of more than $4,500 in operating income reflecting additional cash provided by the BellSouth acquisition and our success in achieving merger synergies and operational efficiencies, partially offset by increased interest payments of approximately $1,800 and tax payments of $1,200. Tax payments were higher due primarily to a $1,000 deposit related to the IRS examination of our 2000 – 2002 income tax returns.

Cash Used in or Provided by Investing Activities

During 2008, cash used in investing activities consisted of:

- $19,676 in capital expenditures, excluding interest during construction.
- $659 in interest during construction.
- $9,497 for the purchase of spectrum licenses including the 700 MHz Band wireless spectrum auction and the acquisition of licenses from Aloha Partners, L.P.
- $350 related to a customer list acquisition.
- $697 related to various wireless-related acquisitions.
- $275 for the acquisition of Wayport.
- $153 related to other acquisitions.

During 2008, cash provided by investing activities consisted of:

- $1,501 from dispositions of non-strategic assets.
- $436 from EchoStar from an investment made in 2003.
- $114 from the sale of marketable and equity securities.
- $113 related to other activities.

Our capital expenditures are primarily for our wireless and wireline subsidiaries' networks, our U-verse services, and support systems for our communications services. Capital spending (excluding interest during construction) in our wireless segment increased 42.1% in 2008, primarily for network capacity expansion, integration and upgrades to our Universal Mobile Telecommunications System/High-Speed Packet Access network, as well as for IT and other support systems for our wireless service. Capital expenditures in the wireline segment, which represented 69.4% of our capital expenditures, increased 2.5% in 2008, primarily due to the continued deployment of our U-verse services.

The other segment capital expenditures were less than 2% of total capital expenditures for 2008. Included in the other segment are equity investments, which should be self-funding as they are not direct AT&T operations; as well as corporate, diversified business and Sterling operations, which we expect to fund using cash from operations. We expect to fund any advertising & publishing segment capital expenditures using cash from operations.

Cash Used in or Provided by Financing Activities

In December 2007, our Board of Directors authorized a new share repurchase plan of 400 million shares, which replaces our previous share repurchase authorization from March 2006. During 2008, we repurchased 164 million shares at a cost of $6,077. These 2008 share repurchases are the only ones made under the current authorization. This new authorization represents approximately 6.7% of AT&T's shares outstanding at December 31, 2008 and expires at the end of 2009. We have repurchased, and may continue to repurchase, a portion of the shares pursuant to plans that comply with the requirements of Rule 10b5-1(c) under the Securities Exchange Act of 1934. We will fund any additional share repurchases through a combination of cash from operations, borrowings dependent upon market conditions, and cash from the disposition of certain non-strategic investments. However, we anticipate concentrating on reducing debt levels rather than share repurchases in 2009.

We paid dividends of $9,507 in 2008, $8,743 in 2007 and $5,153 in 2006, reflecting the issuance of additional shares for the BellSouth and ATTC acquisitions and dividend rate increases. In December 2008, our Board of Directors approved a 2.5% increase in the quarterly dividend from $0.40 to $0.41 per share. This increase recognizes our expectations for growth and follows a 12.7% dividend increase approved by AT&T's Board in December 2007. Dividends declared by our Board of Directors totaled $1.61 per share in 2008, $1.465 per share in 2007 and $1.35 per share in 2006. Our dividend policy considers both the expectations and requirements of stockholders, internal requirements of AT&T and long-term growth opportunities. It is our intent to provide the financial flexibility to allow our Board of Directors to consider dividend growth and to recommend an increase in dividends to be paid in future periods. All dividends remain subject to approval by our Board of Directors.

At December 31, 2008, we had $14,119 of debt maturing within one year, which included $9,503 of long-term debt maturities and $4,616 of commercial paper borrowings and other borrowings. Most of our commercial paper borrowings are due within 90 days. We continue to examine our mix of short- and long-term debt in light of interest rate trends and current credit market conditions.

During 2008, we received net proceeds of $12,416 from the issuance of $12,475 in long-term debt. Debt proceeds were used for general corporate purposes and parts of the proceeds were used for repurchases of our common stock. Long-term debt issuances consisted of:

- $2,500 of 5.5% global notes due in 2018.
- $2,000 of floating rate notes due 2010 in a private offering, which can be redeemed by the holder early (which is classified as debt maturing in one year).
- €1,250 of 6.125% global notes due 2015 (equivalent to approximately $1,975 when issued).
- $1,500 of 4.95% global notes due in 2013.
- $1,250 of 6.4% global notes due 2038.
- $1,000 of 5.6% global notes due 2018.
- $750 of 6.3% global notes due in 2038.
- $1,500 of 6.7% global notes due in 2013.

Beginning in May 2009, a $500 zero-coupon puttable note may be presented for redemption by the holder at specified dates but not more frequently than annually, excluding 2011. If the note is held to maturity in 2022, the redemption amount will be $1,030.

In November 2008, we agreed to acquire Centennial Communications, a wireless operator in portions of the United States and Puerto Rico, including its outstanding debt of approximately $2,000. All of Centennial's debt was callable after January 2009. The various debt agreements contain a number of restrictive operating covenants, which make it likely that we will call such debt upon closing of the acquisition.

We entered into fixed-to-fixed cross-currency swaps on our 2015 euro-denominated debt instruments to hedge our exposure to changes in foreign currency exchange rates. These hedges also include interest rate swaps of a fixed euro-denominated interest rate to a fixed U.S.-denominated interest rate, which results in a U.S.-denominated semiannual rate of 5.77%.

During 2008, debt repayments totaled $4,010 and consisted of:

- $3,915 related to debt repayments with a weighted-average interest rate of 3.98%.
- $66 related to repayments of Edge Wireless term loan.
- $29 related to scheduled principal payments on other debt and repayments of other borrowings.

We have a five-year $10,000 credit agreement with a syndicate of investment and commercial banks, which we have the right to increase up to an additional $2,000, provided no event of default under the credit agreement has occurred. One of the participating banks is Lehman Brothers Bank, Inc., which recently declared bankruptcy. We are unable to determine the status of its stated commitment of $595 at this time. The current agreement will expire in July 2011. We also have the right to terminate, in whole or in part, amounts committed by the lenders under this agreement in excess of any outstanding advances; however, any such terminated commitments may not be reinstated. Advances under this agreement may be used for general corporate purposes, including support of commercial paper borrowings and other short-term borrowings. There is no material adverse change provision governing the drawdown of advances under this credit agreement. This agreement contains a negative pledge covenant, which requires that, if at any time we or a subsidiary pledge assets or otherwise permits a lien on its properties, advances under this agreement will be ratably secured, subject to specified exceptions. We must maintain a debt-to-EBITDA (earnings before interest, income taxes, depreciation and amortization, and other modifications described in the agreement) financial ratio covenant of not more than three-to-one as of the last day of each fiscal quarter for the four quarters then ended. We comply with all covenants under the agreement. At December 31, 2008, we had no borrowings outstanding under this agreement (see Note 8).

During 2008, proceeds of $319 from the issuance of treasury shares were related to the settlement of share-based awards.

During 2007, we paid $190 to minority interest holders and $47 to terminate interest rate swaps with notional amounts totaling $1,800 acquired as a result of our acquisition of BellSouth.

In February of 2009, we issued $1,000 of 4.85% global notes due 2014, $2,250 of 5.8% global notes due 2019 and $2,250 of 6.55% global notes due 2039.

We plan to fund our 2009 financing activities through a combination of debt issuances and cash from operations. Our financing activities emphasis will be on the repayment of debt. We will continue to examine opportunities to fund our activities by issuing debt at favorable rates and with cash from the disposition of certain other non-strategic investments.

Other

Our total capital consists of debt (long-term debt and debt maturing within one year) and stockholders' equity. Our capital structure does not include debt issued by our international equity investees. Our debt ratio was 43.8%, 35.7%, and 34.1% at December 31, 2008, 2007 and 2006. The debt ratio is affected by the same factors that affect total capital. Total capital decreased $8,144 in 2008 compared to an increase of $4,146 in 2007. The 2008 total capital decrease was due to a $16,677 decrease in accumulated other comprehensive loss that reflects a decrease in retirement plans funded status partially offset by an increase in debt of $10,876 related to our financing activities. Our stockholders' equity balance was down $19,020 primarily due to the decrease in retirement plan funded status discussed above.

The primary factor contributing to the increase in our 2007 debt ratio was the increase in debt of $4,319 related to our financing activities. Our stockholders' equity balance decreased $173 and included our increase in net income and current adjustments for unrealized pension and postretirement gains, which were more than offset by our increased share repurchase activity and dividend distributions.

CONTRACTUAL OBLIGATIONS, COMMITMENTS AND CONTINGENCIES

Current accounting standards require us to disclose our material obligations and commitments to making future payments under contracts, such as debt and lease agreements, and under contingent commitments, such as debt guarantees. We occasionally enter into third-party debt guarantees, but they are not, nor are they reasonably likely to become, material. We disclose our contractual long-term debt repayment obligations in Note 8 and our operating lease payments in Note 5. Our contractual obligations do not include expected pension and postretirement payments as we maintain pension funds and Voluntary Employee Beneficiary Association trusts to fully or partially fund these benefits (see Note 11). In the ordinary course of business, we routinely enter into commercial commitments for various aspects of our operations, such as plant additions and office supplies. However, we do not believe that the commitments will have a material effect on our financial condition, results of operations or cash flows.

Our contractual obligations as of December 31, 2008, are in the following table. The purchase obligations that follow are those for which we have guaranteed funds and will be funded with cash provided by operations or through incremental borrowings. The minimum commitment for certain obligations is based on termination penalties that could be paid to exit the contract. Since termination penalties would not be paid every year, such penalties are excluded from the table. Other long-term liabilities were included in the table based on the year of required payment or an estimate of the year of payment. Such estimate of payment is based on a review of past trends for these items, as well as a forecast of future activities. Certain items were excluded from the following table as the year of payment is unknown and could not be reliably estimated since past trends were not deemed to be an indicator of future payment.

Substantially all of our purchase obligations are in our wireline and wireless segments. The table does not include the fair value of our interest rate swaps. Our capital lease obligations have been excluded from the table due to the immaterial value at December 31, 2008. Many of our other noncurrent liabilities have been excluded from the following table due to the uncertainty of the timing of payments, combined with the absence of historical trending to be used as a predictor of such payments. Additionally, certain other long-term liabilities have been excluded since settlement of such liabilities will not require the use of cash. However, we have included in the following table obligations which primarily relate to benefit funding and severance due to the certainty of the timing of these future payments. Our other long-term liabilities are: deferred income taxes (see Note 10) of $19,196; postemployment benefit obligations (see Note 11) of $31,930; and other noncurrent liabilities of $14,610, which included deferred lease revenue from our agreement with American Tower of $539 (see Note 5).

Contractual Obligations

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations[1]	$ 68,444	$ 9,504	$11,303	$10,721	$36,916
Interest payments on long-term debt	57,593	4,091	7,075	5,543	40,884
Commercial paper obligations	4,575	4,575	—	—	—
Other short-term borrowings	41	41	—	—	—
Operating lease obligations	20,444	2,382	4,133	3,359	10,570
Unrecognized tax benefits[2]	6,801	1,759	—	—	5,042
Purchase obligations[3,4]	9,911	3,112	4,398	1,885	516
Other long-term obligations[5]	475	175	148	66	86
Total Contractual Obligations	$168,284	$25,639	$27,057	$21,574	$94,014

[1]The impact of premiums/discounts and derivative instruments included in debt amounts on the balance sheet are excluded from the table.
[2]The non-current portion of the unrecognized tax benefits is included in the "More than 5 Years" column as we cannot reasonably estimate the timing or amounts of additional cash payments, if any, at this time. See Note 10 for additional information.
[3]We have contractual obligations to utilize network facilities from local exchange carriers with terms greater than one year. Since the contracts have no minimum volume requirements and are based on an interrelationship of volumes and discounted rates, we assessed our minimum commitment based on penalties to exit the contracts, assuming that we had exited the contracts on December 31, 2008. At December 31, 2008, the termination fees we would have incurred to exit all of these contracts would have been $213. These termination fees could be $167 in 2009, $45 in the aggregate for 2010 and 2011 and $1 for 2012, assuming that all contracts are exited. These termination fees are excluded from the above table as the fees would not be paid every year and the timing of such payments, if any, is uncertain.
[4]We calculated the minimum obligation for certain agreements to purchase goods or services based on termination fees that can be paid to exit the contract. If we elect to exit these contracts, termination fees for all such contracts in the year of termination could be approximately $368 in 2009, $418 in the aggregate for 2010 and 2011, $185 in the aggregate for 2012 and 2013 and $35 in the aggregate, thereafter. Certain termination fees are excluded from the above table as the fees would not be paid every year and the timing of such payments, if any, is uncertain.
[5]Other long-term obligations include commitments with local exchange carriers for dedicated leased lines.

MARKET RISK

We are exposed to market risks primarily from changes in interest rates and foreign currency exchange rates. In managing exposure to these fluctuations, we may engage in various hedging transactions that have been authorized according to documented policies and procedures. On a limited basis, we use certain derivative financial instruments, including foreign currency exchange contracts and combined interest rate foreign currency contracts, to manage these risks. We do not use derivatives for trading purposes, to generate income or to engage in speculative activity. Our capital costs are directly linked to financial and business risks. We seek to manage the potential negative effects from market volatility and market risk. The majority of our financial instruments are medium- and long-term fixed rate notes and debentures. Fluctuations in market interest rates can lead to significant fluctuations in the fair value of these notes and debentures. It is our policy to manage our debt structure and foreign exchange exposure in order to manage capital costs, control financial risks and maintain financial flexibility over the long term. Where appropriate, we will take actions to limit the negative effect of interest and foreign exchange rates, liquidity and counterparty risks on stockholder value.

We enter into foreign currency contracts to minimize our exposure to risk of adverse changes in currency exchange rates. We are subject to foreign exchange risk for foreign currency-denominated transactions, such as debt issued, recognized payables and receivables and forecasted transactions. At December 31, 2008, our foreign currency exposures were principally Mexican pesos, Euros, Danish krone, Swedish krona and Canadian dollars.

QUANTITATIVE INFORMATION ABOUT MARKET RISK

In order to determine the changes in fair value of our various financial instruments, we use certain financial modeling techniques. We apply rate-sensitivity changes directly to our interest rate swap transactions and forward rate sensitivity to our foreign currency-forward contracts.

The changes in fair value, as discussed below, assume the occurrence of certain market conditions, which could have an adverse financial impact on AT&T and do not represent projected gains or losses in fair value that we expect to incur. Future impacts would be based on actual developments in global financial markets. We do not foresee any significant changes in the strategies used to manage interest rate risk, foreign currency rate risk or equity price risk in the near future.

Dollars in millions except per share amounts

Interest Rate Sensitivity The principal amounts by expected maturity, average interest rate and fair value of our liabilities that are exposed to interest rate risk are described in Notes 8 and 9. Following are our interest rate derivatives, subject to interest rate risk as of December 31, 2008. The interest rates illustrated in the interest rate swaps section of the table below refer to the average expected rates we would receive and the average expected rates we would pay based on the contracts. The notional amount is the principal amount of the debt subject to the interest rate swap contracts. The net fair value asset (liability) represents the amount we would receive or pay if we had exited the contracts as of December 31, 2008.

	Maturity							
	2009	2010	2011	2012	2013	After 2013	Total	Fair Value 12/31/08
Interest Rate Derivatives								
Interest Rate Swaps:								
Receive Fixed/Pay Variable Notional Amount	—	—	$1,250	$1,750	$1,750	$1,000	$5,750	$564
Variable Rate Payable[1]	2.8%	2.4%	3.4%	3.6%	4.0%	4.1%		
Weighted-Average Fixed Rate Receivable	5.6%	5.6%	5.5%	5.3%	5.6%	5.6%		

[1]Interest payable based on current and implied forward rates for Three or Six Month LIBOR plus a spread ranging between approximately 36 and 175 basis points.

We had fair value interest rate swaps with a notional value of $5,750 with a net carrying and fair value asset of $564 at December 31, 2008. At December 31, 2007, we had notional value of $3,250 with an asset of $88.

Foreign Exchange Forward Contracts The fair value of foreign exchange contracts is subject to changes in foreign currency exchange rates. For the purpose of assessing specific risks, we use a sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our financial instruments and results of operations. To perform the sensitivity analysis, we assess the risk of loss in fair values from the effect of a hypothetical 10% change in the value of foreign currencies (negative change in the value of the U.S. dollar), assuming no change in interest rates. See Note 9 to the consolidated financial statements for additional information relating to notional amounts and fair values of financial instruments.

For foreign exchange forward contracts outstanding at December 31, 2008, assuming a hypothetical 10% depreciation of the U.S. dollar against foreign currencies from the prevailing foreign currency exchange rates, the fair value of the foreign exchange forward contracts (net liability) would have decreased approximately $13. Because our foreign exchange contracts are entered into for hedging purposes, we believe that these losses would be largely offset by gains on the underlying transactions.

The risk of loss in fair values of all other financial instruments resulting from a hypothetical 10% change in market prices was not significant as of December 31, 2008.

QUALITATIVE INFORMATION ABOUT MARKET RISK

Foreign Exchange Risk From time to time, we make investments in businesses in foreign countries, receive dividends and proceeds from sales or borrow funds in foreign currency. Before making an investment, or in anticipation of a foreign currency receipt, we often will enter into forward foreign exchange contracts. The contracts are used to provide currency at a fixed rate. Our policy is to measure the risk of adverse currency fluctuations by calculating the potential dollar losses resulting from changes in exchange rates that have a reasonable probability of occurring. We cover the exposure that results from changes that exceed acceptable amounts. We do not speculate in foreign exchange markets.

Interest Rate Risk We issue debt in fixed and floating rate instruments. Interest rate swaps are used for the purpose of controlling interest expense by managing the mix of fixed and floating rate debt. Interest rate forward contracts are utilized to hedge interest expense related to debt financing. We do not seek to make a profit from changes in interest rates. We manage interest rate sensitivity by measuring potential increases in interest expense that would result from a probable change in interest rates. When the potential increase in interest expense exceeds an acceptable amount, we reduce risk through the issuance of fixed-rate (in lieu of variable-rate) instruments and the purchase of derivatives.

Issuer Equity Repurchases

On December 10, 2007, our Board of Directors authorized a new share repurchase plan of 400 million shares, which replaces our previous share repurchase authorization. During 2008, we repurchased 164 million shares at a cost of $6,077. This new authorization represents approximately 6.7% of AT&T's shares outstanding at December 31, 2008, and expires at the end of 2009. We may continue to repurchase, a portion of the shares pursuant to plans that comply with the requirements of Rule 10b5-1(c) under the Securities Exchange Act of 1934. We will fund any share repurchases through a combination of cash from operations, borrowings dependent upon market conditions and cash from the disposition of certain non-strategic investments but anticipate concentrating on reducing debt levels rather than share repurchases in 2009.

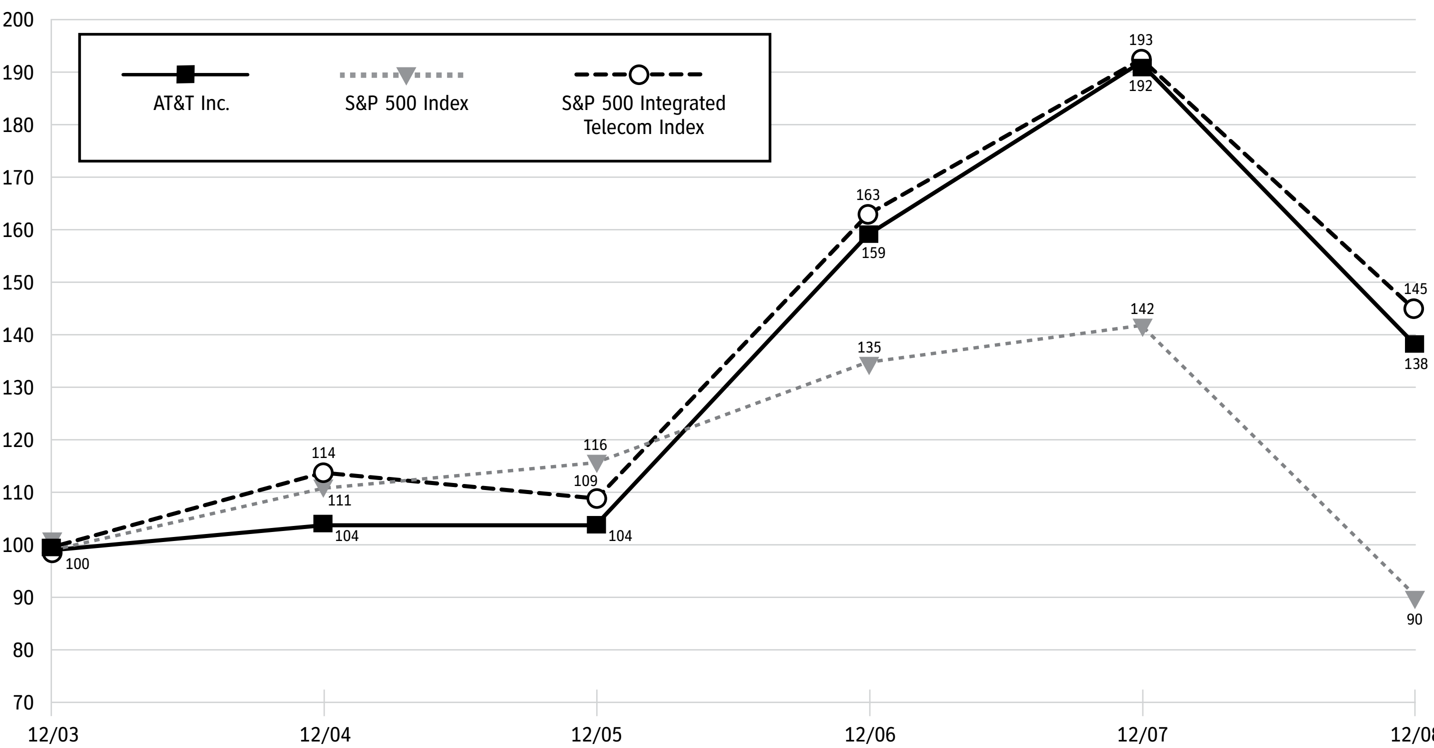
Purchase Period	Total Number of Shares Purchased	Average Price Paid per Share[1]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 30, 2008 – January 31, 2008	10,000,000	$35.70	10,000,000	390,000,000
February 1, 2008 – February 29, 2008	77,133,333	$36.78	77,133,333	312,866,667
March 3, 2008 – March 31, 2008	24,500,000	$35.77	24,500,000	288,366,667
May 6, 2008 – May 30, 2008	23,700,000	$39.38	23,700,000	264,666,667
June 2, 2008 – June 30, 2008	28,900,000	$37.08	28,900,000	235,766,667
Total	164,233,333	$36.99	164,233,333	235,766,667

[1]Average Price Paid per Share excludes transaction costs.

STOCK PERFORMANCE GRAPH

Comparison of Five-Year Cumulative Total Return

AT&T Inc., S&P 500 Index, and S&P 500 Integrated Telecom Index



The comparison above assumes $100 invested on December 31, 2003, in AT&T common stock, Standard & Poor's 500 Index (S&P 500), and Standard & Poor's 500 Integrated Telecom Index (Telecom Index). Total return equals stock price appreciation plus reinvestment of dividends on a quarterly basis.

CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER

As required under the rules of the New York Stock Exchange (NYSE), our chief executive officer has timely submitted to the NYSE his annual certification that he is not aware of any violation by the company of NYSE corporate governance standards. Also as required under the rules of the NYSE, readers are advised that the certifications required under Section 302 of the Sarbanes-Oxley Act of 2002 are not included in this report but instead are included as exhibits to our Annual Report on Form 10-K for 2008.

RISK FACTORS

In addition to the other information set forth in this document, including the matters contained under the caption "Cautionary Language Concerning Forward-Looking Statements," you should carefully read the matters described below. We believe that each of these matters could materially affect our business. We recognize that most of these factors are beyond our ability to control and therefore to predict an outcome. Accordingly, we have organized them by first addressing general factors, then industry factors and, finally, items specifically applicable to us.

A worsening U.S. economy would magnify our customers' and suppliers' current financial difficulties and could materially adversely affect our business.

We provide services and products to consumers and large and small businesses in the United States and to larger businesses throughout the world. The current economic recession in the U.S. has adversely affected our customers' demand for and ability to pay for existing services, especially local landline service, and their interest in purchasing new services. Our suppliers are also facing higher financing and operating costs. Should these current economic conditions worsen, we likely would experience both a further decrease in revenues and an increase in certain expenses, including expenses relating to bad debt and equipment and software maintenance. We also may incur difficulties locating financially stable equipment and other suppliers thereby affecting our ability to offer attractive new services. We are also likely to experience greater pressure on pricing and margins as we continue to compete for customers who would have even less discretionary income. While our largest business customers have been less affected by these adverse changes in the U.S. economy, if the continued adverse economic conditions in the U.S., Europe and other foreign markets persist or worsen, those customers would likely be affected in a similar manner.

Adverse changes in medical costs and the U.S. securities markets and interest rates could materially increase our benefit plan costs.

Our pension and postretirement costs are subject to increases, primarily due to continuing increases in medical and prescription drug costs and can be affected by lower returns in prior years on funds held by our pension and other benefit plans, which are reflected in our financial statements over several years. Investment returns on these funds depend largely on trends in the U.S. securities markets and the U.S. economy. In calculating the annual costs included on our financial statements of providing benefits under our plans, we have made certain assumptions regarding future investment returns, medical costs and interest rates. If actual investment returns, medical costs and interest rates are worse than those previously assumed, our annual costs will increase. We experienced significant actual investment losses during 2008, which will cause a significant increase in our benefit plan costs during 2009.

The FASB required companies to recognize the funded status of defined benefit pension and postretirement plans as an asset or liability in our statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Therefore, an increase in our costs will have a negative effect on our balance sheet.

The ongoing uncertainty in global financial markets could materially adversely affect our ability and our larger customers' ability to access capital needed to fund business operations.

The recent instability in the global financial markets and ongoing uncertainty affecting these markets have resulted in extreme volatility in the credit, equity and fixed income markets. This volatility has limited, in some cases severely, most companies' access to the credit markets, leading to significantly higher borrowing costs for companies or, in many cases, the inability of these companies to fund their ongoing operations. As a result, our larger customers, who tend to be heavy users of our data and wireless services, may be forced to delay, reduce or be unable to finance, purchases of our products and services and may delay payment or default on outstanding bills to us. In addition, we contract with large financial institutions to support our own treasury operations, including contracts to hedge our exposure on interest rates and foreign exchange, and the funding of credit lines and other short-term debt obligations, including commercial paper. While we have been successful in continuing to access the credit and fixed income markets when needed, a financial crisis could render us unable to access these markets, severely affecting our business operations.

Changes in available technology could increase competition and our capital costs.

The telecommunications industry has experienced rapid changes in the last several years. The development of wireless, cable and IP technologies has significantly increased the commercial viability of alternatives to traditional wireline telephone service and enhanced the capabilities of wireless networks. In order to remain competitive, we have begun to deploy a more sophisticated wireline network and continue to deploy a more sophisticated wireless network, as well as research other new technologies. If the new technologies we have adopted or on which we have focused our research efforts fail to be cost-effective and accepted by customers, our ability to remain competitive could be materially adversely affected.

Changes to federal, state and foreign government regulations and decisions in regulatory proceedings could materially adversely affect us.

Our wireline subsidiaries are subject to significant federal and state regulation while many of our competitors are not. In addition, our subsidiaries and affiliates operating outside the U.S. are also subject to the jurisdiction of national and supranational regulatory authorities in the market where service is provided. Our wireless subsidiaries are regulated to varying degrees by the FCC and some state and local agencies. The adoption of new regulations or changes to existing regulations could significantly increase our costs, which either would reduce our operating margins or potentially increase customer turnover should we attempt to increase prices to cover our increased costs. In addition, the development of new technologies, such as IP-based services, has created or potentially could create conflicting regulation between the FCC and various state and local authorities, which may involve lengthy litigation to resolve and may result in outcomes unfavorable to us.

Increasing competition in our wireline markets could adversely affect wireline operating margins.

We expect competition in the telecommunications industry to continue to intensify. We expect this competition will continue to put pressure on pricing, margins and customer retention. A number of our competitors that rely on alternative technologies (e.g., wireless, cable and VoIP) are typically subject to less (or no) regulation than our wireline and ATTC subsidiaries and therefore are able to operate with lower costs. These competitors also have cost advantages compared to us, due in part to a nonunionized workforce, lower employee benefits and fewer retirees (as most of the competitors are relatively new companies). We believe such advantages can be offset by continuing to increase the efficiency of our operating systems and by improving employee training and productivity; however, there can be no guarantee that our efforts in these areas will be successful.

Increasing competition in the wireless industry could adversely affect our operating results.

On average, we have three to four other wireless competitors in each of our service areas and compete for customers based principally on price, service/device offerings, call quality, coverage area and customer service. In addition, we are likely to experience growing competition from providers offering services using alternative wireless technologies and IP-based networks as well as traditional wireline networks. We expect intense industry competition and market saturation may cause the wireless industry's customer growth rate to moderate in comparison with historical growth rates. We expect that the availability of additional 700 MHz spectrum could increase competition and the effectiveness of existing competition. This competition will continue to put pressure on pricing and margins as companies compete for potential customers. Our ability to respond will depend, among other things, on continued improvement in network quality and customer service and effective marketing of attractive products and services, and cost management. These efforts will involve significant expenses and require strategic management decisions on, and timely implementation of equipment choices, marketing plans and financial budgets.

Equipment failures, natural disasters and terrorist attacks may materially adversely affect our operations.

Major equipment failures or natural disasters, including severe weather, terrorist acts or other breaches of network or IT security that affect our wireline and wireless networks, including telephone switching offices, microwave links, third-party owned local and long-distance networks on which we rely, our cell sites or other equipment, could have a material adverse effect on our operations. While we have insurance coverage for some of these events, our inability to operate our wireline or wireless systems, even for a limited time period, may result in significant expenses, a loss of customers or impair our ability to attract new customers, which could have a material adverse effect on our business, results of operations and financial condition.

The success of our U-verse services initiative will depend on the timing, extent and cost of deployment; the development of attractive and profitable service offerings; the extent to which regulatory, franchise fees and build-out requirements apply to this initiative; and the availability and reliability of the various technologies required to provide such offerings.

The trend in telecommunications technology is to shift from the traditional circuit- and wire-based technology to IP-based technology. IP-based technology can transport voice and data, as well as video, from both wired and wireless networks. IP-based networks also potentially cost less to operate than traditional networks. Our competitors, many of which are newer companies, are deploying this IP-based technology. In order to continue to offer attractive and competitively priced services, we are deploying a new broadband network to offer IP-based voice, data and video services. Using a new and sophisticated technology on a very large scale entails risks but also presents opportunities to expand service offerings to customers. Should deployment of our network be delayed or costs exceed expected amounts, our margins would be adversely affected and such effects could be material. Should regulatory requirements be different than we anticipated, our deployment could be delayed, perhaps significantly, or limited to only those geographical areas where regulation is not burdensome. In addition, should the delivery of services expected to be deployed on our network be delayed due to technological or regulatory constraints, performance of suppliers, or other reasons, or the cost of providing such services becomes higher than expected, customers may decide to purchase services from our competitors, which would adversely affect our revenues and margins, and such effects could be material.

A majority of our workforce is represented by labor unions. Absent the successful negotiation of certain agreements, we could experience lengthy work stoppages when these contracts expire during 2009.

A majority of our employees are represented by labor unions as of year-end 2008. Labor contracts covering many of these employees will expire during 2009. We experienced a work stoppage in 2004 when the contracts involving our wireline employees expired, and we may experience additional work stoppages this year. A work stoppage could adversely affect our business operations, including a loss of revenue and strained relationships with customers, and we can not predict the length of any such strike. We can not predict what will be the unions' requirements for a new contract nor the impact of a new contract on our financial condition.

CAUTIONARY LANGUAGE CONCERNING FORWARD-LOOKING STATEMENTS

Information set forth in this report contains forward-looking statements that are subject to risks and uncertainties, and actual results could differ materially. Many of these factors are discussed in more detail in the "Risk Factors" section. We claim the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

The following factors could cause our future results to differ materially from those expressed in the forward-looking statements:

- Adverse economic and/or capital access changes in the markets served by us or in countries in which we have significant investments, including the impact on customer demand and our ability to access financial markets.
- Changes in available technology and the effects of such changes including product substitutions and deployment costs.
- Increases in our benefit plans' costs including increases due to adverse changes in the U.S. and foreign securities markets, resulting in worse-than-assumed investment returns and discount rates, and adverse medical cost trends.
- The final outcome of Federal Communications Commission proceedings and reopenings of such proceedings and judicial review, if any, of such proceedings, including issues relating to access charges, broadband deployment, unbundled loop and transport elements and wireless services.
- The final outcome of regulatory proceedings in the states in which we operate and reopenings of such proceedings, and judicial review, if any, of such proceedings, including proceedings relating to interconnection terms, access charges, universal service, unbundled network elements and resale and wholesale rates, broadband deployment including our U-verse services, performance measurement plans, service standards and traffic compensation.
- Enactment of additional state, federal and/or foreign regulatory and tax laws and regulations pertaining to our subsidiaries and foreign investments.
- Our ability to absorb revenue losses caused by increasing competition and economic pressure, including offerings using alternative technologies (e.g., cable, wireless and VoIP), and our ability to maintain capital expenditures.
- The extent of competition and the resulting pressure on access line totals and wireline and wireless operating margins.
- Our ability to develop attractive and profitable product/service offerings to offset increasing competition in our wireless and wireline markets.
- The ability of our competitors to offer product/service offerings at lower prices due to lower cost structures and regulatory and legislative actions adverse to us, including state regulatory proceedings relating to unbundled network elements and nonregulation of comparable alternative technologies (e.g., VoIP).
- The timing, extent and cost of deployment of our U-verse services (our Lightspeed initiative); the development of attractive and profitable service offerings; the extent to which regulatory, franchise fees and build-out requirements apply to this initiative; and the availability, cost and/or reliability of the various technologies and/or content required to provide such offerings.
- The outcome of pending or threatened litigation including patent claims by or against third parties.
- The impact on our networks and business of major equipment failures, severe weather conditions, natural disasters or terrorist attacks.
- The issuance by the Financial Accounting Standards Board or other accounting oversight bodies of new accounting standards or changes to existing standards.
- The issuance by the Internal Revenue Service and/or state tax authorities of new tax regulations or changes to existing standards and actions by federal, state or local tax agencies and judicial authorities with respect to applying applicable tax laws and regulations; and the resolution of disputes with any taxing jurisdictions.
- Our ability to adequately fund our wireless operations, including access to additional spectrum; network upgrades and technological advancements.
- Changes in our corporate strategies, such as changing network requirements or acquisitions and dispositions, to respond to competition and regulatory, legislative and technological developments.

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially affect our future earnings.