

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

T - AT&T Inc. at Sanford C. Bernstein & Co. Strategic Decisions
Conference

EVENT DATE/TIME: JUNE 01, 2012 / 1:00PM GMT



CORPORATE PARTICIPANTS

Randall Stephenson *AT&T Inc. - Chairman, CEO & President*

CONFERENCE CALL PARTICIPANTS

Craig Moffett *Sanford C. Bernstein & Co. - Analyst*

PRESENTATION

Craig Moffett - *Sanford C. Bernstein & Co. - Analyst*

Good morning, everyone. Thank you for joining us for the final day of our 28th Annual Strategic Decisions Conference. And thank you, all, who are joining us on the web, as well, for joining us this morning for our conversation with Randall Stephenson of AT&T. Randall, I think this is your fourth consecutive year, I think it is, so delighted to have you back.

Randall Stephenson - *AT&T Inc. - Chairman, CEO & President*

Good to be back.

Craig Moffett - *Sanford C. Bernstein & Co. - Analyst*

Before we start in on AT&T, investors I think are going to be focused this morning on a very weak jobs report, and a tick up in the unemployment number. I've always thought you probably had more visibility into the economy than just about any kind of company in America. What are you seeing in your small business customer relationships, your retail customer relationships, that gives you insight into where the economy is right now?

Randall Stephenson - *AT&T Inc. - Chairman, CEO & President*

If I could just take care of legal business here -- our Safe Harbor is up here on the screen. May contain forward-looking statements. So if you would, just make note of that.

I'll give you kind of a quick walk down of what we are seeing, and I'm going to stay focused on the business side, because I think it is the most instructive in terms of what's happening -- what happens elsewhere; probably the most predictive.

If you take our business -- in fact, we just finished a lot of our reviews, and went through a lot of this. But the very high end of business -- we are seeing good, robust investment. I mean, people are spending money. The wallets are open. And so that's obviously having an effect on us because it's giving us the opportunity to go in and put in managed network type services. And so that looks and feels pretty good.

I will tell you at the upper end of the business, though, the part of our business that is driven by rear ends in seats -- and that's employment -- is, this morning, I guess from our viewpoint, if you had asked us to forecast, we wouldn't have been too far off from this. I mean, everybody's in a certain range around this, but we are not seeing any hiring in the upper end of business in the US. Everybody talks about yes, we are hiring, but people aren't hiring a lot in the US. And it's very consistent with what we're seeing up market.

As you go down market, it's getting tighter and tighter, and you're seeing the wallet for investment being less open, if you will. And if you get all the way down to the low end small business market, we are still in an environment for I forget how many consecutive months now -- I think 2010 was the last month where we saw positive new business starts.



And new business starts is always the variable that I stay focused on more than anything, because it's the best predictor for our business in terms of job creation and growth for our services. And new business starts down at the bottom end are still in negative territory. And until we see that begin to tick up, we are not forecasting for ourselves any kind of change in trajectory of the current economic environment.

We are still looking at the last half of the year -- best case, we are thinking about a positive 1% growth in the US economy. And I -- I don't know. Internally, we have our own debates. I view that as probably optimistic right now, to achieve that kind of growth.

So, you know, up end, the wallets are open; people are investing. But the further you go down market, the tighter they are, and seeing no hiring, basically, that would drive our type of business.

Craig Moffett - *Sanford C. Bernstein & Co. - Analyst*

Well, again, consistent, I think, with what we saw this morning.

Let's transition a little bit now to AT&T specifically. And a lot has happened since you were on the stage a year ago. You obviously -- at the time you were here last year, prospects still looked very good for your planned merger with T-Mobile. Obviously, that never happened; your path to acquiring spectrum through that deal was blocked. And obviously, one path to consolidating the wireless industry was blocked through that deal as well.

Take us through the last year and kind of what you've learned in the last year in the wake of that attempted merger. Do you feel better about this state of the business now, or more constrained about spectrum? Where are we right now?

Randall Stephenson - *AT&T Inc. - Chairman, CEO & President*

The sense of urgency around spectrum is no less intense than it was a year ago. It is still the issue for our industry. And it is the issue that cannot be addressed -- it cannot be remedied absent some movement from a public policy standpoint.

Now, that said, it doesn't mean that it can't be fixed. I think there are a number of avenues that can be taken to address the spectrum issue in the short run, and over the last year, we've obviously spent a lot of time evaluating what are the avenues the industry can pursue for spectrum? And to your point, lessons learned. Large-scale M&A is probably not going to happen in this industry, at least for the foreseeable future. If somebody wants to take it on, it is a very difficult and painful process to take it on.

And so we are all saying, okay, without large-scale M&A, what is the path to aggregating spectrum and getting more capacity online to accommodate the growth we're all experiencing? And the fact of the matter is -- or let me back up. A lot of the government policy to date has been around how do we get more of the government controlled spectrum to market? And I think that's very important, and I applaud what the legislators have done. I applaud what Julius Genachowski and his team have done to get 50 megahertz brought to market.

But that in the whole scheme of things is inconsequential. It needs to be done -- to keep going -- but 50 megahertz with five or six carriers out here needing capacity is -- it's a ripple. It's a ripple in the pond. And it's not that relevant. Keep going, keep moving, but that's six, eight years out, and it's not very significant.

If we want to move the needle in the short run, there is a lot of spectrum out in private hands today, and that spectrum needs to be approved for use in mobile broadband, or there needs to be processes brought to bear that would allow that to exchange hands quickly and efficiently. If you were to get the approval for some of the spectrums to the marketplace, put on that spectrum use it or lose it conditions, and then streamline the process for it to change hands, a lot of this problem gets relieved in very short order.



And so that's what our focus is right now. We need to go identify the spectrum; a ton of work going on. The surprising thing for a lot of people is there's a lot of spectrum out there. We just need to get the regulatory approval process moving. And so we're working with the regulators to help make that happen.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

You said spectrum in private hands. There's obviously been some recent talk about trying to take some of the spectrum in public hands and do spectrum sharing. Does that feel like a new path forward, or does it feel like just a fallback position because of recalcitrance from the current owners who aren't willing to give it up, so maybe the next best option is asking if they'll share?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I think there's going to be hybrid models all over the place. There will be spectrum share models. That's something that if you want a model that drives the greatest amount of investment, that drives the greatest amount of innovation, then kind of full ownership of the spectrum has proven over time to be the best model. Spectrum sharing models -- it's really hard for somebody like us to control network quality in a model like that.

I think the technology improves over time, and you could probably make use of some of those capabilities, but in the short run, I don't see that as a fix for addressing the issues we have.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

You warned a year ago that if the deal didn't go through, that there would be very severe consequences, that usage rationing was going to become a fixture, for example. A lot of that has happened. Where are we in that? Are we in the middle innings? Are we going to see the kind of rationing and usage caps continue to tighten because of the lack of additional spectrum, or are we going to start to see them loosen as the technology starts to catch up?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I have no line of sight to a situation where the technology catches up to the utilization curves. We are on a path -- the last five years data usage on our -- actually, on the industry data usage on the mobile networks is up 20,000%. And our current viewpoint is over the next five years it grows 75% per year for each of the next five years. I think Cisco put a study out yesterday that's very consistent with those numbers.

And so there is no great technology solution on the horizon that is going to accommodate that kind of growth and that type of capacity requirements that will somehow mitigate these type of pricing issues.

There's probably only one thing that would help begin to mitigate some of the pricing and rationing that you describe, and that is more spectrum brought to market. I mean, that's the one place where capacity can be brought in a big way. Or, I'll go back to it again, getting more efficient mechanisms in place to allow proper allocation of the spectrum in the marketplace.

So those are the kind of things that bring capacity into the market. I don't want to fall back on T-Mobile, but industry consolidation -- future industry consolidation -- can do nothing but help in this area. And it's just -- to be candid about it, two companies coming together can utilize the same amount of spectrum more efficiently than the two companies separately. That's just arithmetic. It's mechanical. It's just engineering 101.

And so those are the kind of things that will have to happen in the foreseeable future to accommodate this and mitigate the pricing pressure we're seeing. But it shouldn't be a surprise to anybody who has taken a first-year course in economics that as capacity is constrained, and capacity in this industry is constrained, then pricing inherently will move up, and this is what we are experiencing.



Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Well, in the absence of more spectrum, how much can you meet that 20,000% increase by other capital spending? That is, everything from DAS and Wi-Fi upload and cell splitting, and what have you -- is this going to be a more capital-intensive business going forward in order to try to meet the capacity requirements through something other than just adding spectrum?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I think the next -- let me tear it apart. The major thing, absent bringing new spectrum to market, the most important thing that we can do to get more capacity online and more efficient utilization of the spectrum is get to LTE -- get to LTE quick. We are getting 30% to 40% greater efficiency of the spectrum moving to LTE. So think about it -- you move to LTE, you get 30% to 40% efficiency. That's going to make a dent in some of this 75% per-year growth.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

What I was going to say -- a 30% to 40% improvement in efficiency against a 75% annual increase in demand is a -- it's --

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

It's not even consequential, right?

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

It helps, but it's one year, right?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

That's basically right. That's one year that we're talking about. So what else can you do?

You mentioned several of them. Wi-Fi offloads. So we have done -- I think we've probably done more than anybody else in the industry of building a significant Wi-Fi footprint. We were the first in the market to really begin to push Wi-Fi-enabled smartphones. And virtually, I think, virtually every smart phone we have in the market is a Wi-Fi-enabled smartphone. We now have 30,000 hotspots around the United States. And if you're an AT&T customer, you can go to Wi-Fi without charge virtually in any of these locations.

So we've done a great job. We have a very dense footprint of Wi-Fi, for example, in New York. So with all of that effort and all of that investment -- and it's important; we are going to continue doing it -- in New York we offload about 1.5% of our traffic onto these Wi-Fi hotspots. And so it's important. 1.5% of the kind of volumes we do is a lot of traffic, but it's not the fix by itself.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Could it be much more? How big could that (multiple speakers)

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes. Could you double it to 3%, right? Could you quadruple it to 5%? Perhaps. And I think that is going to be a solution.

I think one of the key things we are seeing, particularly as it relates to video, and that is as you move to throttling throughputs, as you move to usage sensitive pricing, and I think we've done a good job of getting the market moved to usage sensitive pricing, what happens is when you think about video, the amount of video consumed on a smartphone, where you're in a work or a home location, is really, really high. So the pricing mechanism is moving people to begin doing a lot of the video offload in their home and business locations. That's important, all right? And that will accommodate a lot of this as we go forward, and it's really, really critical.

Distributed antenna systems, small cells, and so forth -- it's going to take every bit of this. And if you execute really well on every bit of this, and if you get more spectrum brought into your footprint during the next five years, you're still going to be at a place where demand is going to be, by far, be outstripping the supply. And so it gets back to your original question; I think there's going to be pricing pressure in the industry for the foreseeable future.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And upward pricing pressure, that is, to try to ration supply. Is that fair?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Right; yes.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

So now let me try to get granular for the types of things that the green eye shades types like me think about, and that is --

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Green eye shade with a pocket hanging out.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Yes. (Laughter) The postpaid market, if we think about the price times quantity equation for a second, postpaid market growth was negative for the first time ever in the last quarter. One way or the other, I think the rate of growth is certainly slow on the subscriber side.

ARPU, on the other hand, has been very strong -- the strongest you've ever had in the last quarter, driven primarily by mix shift from feature phones to smartphones. What happens when the mix shift either hits a wall and is finished, or even just starts to slow down? And it looks like -- our work says that the incremental ARPU of new smartphones is going down rather than up. Is that -- how do you keep growing ARPU to make that still be a growth business?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

So the ARPU growth has been driven by two things. The migration to smartphones drives tremendous ARPU growth; and then getting the pricing equation right -- usage-sensitive pricing -- as you move to a smartphone and utilization goes up, that also drives ARPU.

But I think it's really important to step back and I don't disagree with the broad thesis you outlined, but understand where we are in that trajectory. So today we have somewhere around over 40 million smartphone customers on the network. That represents 60% of our postpaid base. And of the intake, which we always look at the intake -- what percentage of the intake is moving to a certain technology? Because that's usually a good

predictor as to where stabilization occurs and you can achieve maximum penetration. Well, the intake is at 80%, but that rate has been gradually ticking up as well.

And so let's say that 80% is the best you can get. Well, that means we are at 40-plus million smartphone customers that's driving this ARPU growth. That says you should be able to get to at least 56 million, 60 million smartphone customers. So a lot of penetration left for smartphones that's going to drive a lot of growth, we believe, for the foreseeable future. And that's assuming that you cap at 80 million, and I'm not one that believes you're going to cap at 80%.

But here's the -- here's what's becoming very apparent, and the strategy that we've been pursuing is feeling like we are getting close to the pay off period. That is -- so you've built this really good smartphone base, and we've spent a lot of money, we've invested a lot of capital, to build this base of smartphones, and incredibly high ARPU; the lowest churn that we ever had in our company we've been experiencing over the last couple of quarters. And so now think about this for a moment. Where do the next layer of services and revenues come from? Because you've built this terrific platform of smartphone customers.

Well, all of our smartphone -- not all. A lot of our smartphone customers, in the millions, have these tablets. And the lion's share of these tablets are wireless capable, but they are not being connected to the network. So what do you do to begin to get those devices connected to the network?

And what our customers are saying, and it's taken us a while to figure this out, but it's becoming obvious to us that the customer says, I do not want one more data subscription. Please, no more data subscriptions.

So what we're doing is working aggressively to let them use their smart phone data subscription, that the tablet just is -- it operates off the smartphone subscription. Now, get the pricing right. The pricing is usage sensitive, so that as they have more utilization, it drives utilization and revenue growth from that as well. So the smartphone is a platform.

Put on new devices, the tablet being the easiest to understand -- think about laptops. That's an easy one to understand.

Think about the next 12 months -- the car. I believe the connected car is going to be a terrific opportunity to lever off the smartphone base as well and begin to monetize utilization out of a connected car to these networks.

The smartphone is rapidly becoming your basis for making payments and for doing your banking. Our Isis platform will be launching this year. I'm really excited about this, that the smartphone will be the basis for conducting commerce. There is a tremendous service revenue opportunity off of financial payments and services.

And then you begin to think about things like the connected home. We are putting devices throughout the home, and you're going to see this begin to scale this year. But wireless, LTE-enabled devices throughout the home to do monitoring and to manage the home environment. All of those off a smartphone base.

So there are just a lot of service revenues and new connectivity revenues coming off the smartphone base, and that's what you should expect to see in the future.

You're moving, and I think your point is, you're moving from a world for the green eye shade guys, I don't think of you as a green eye shade guy, but the green eye shade guys are going to stop looking at the business by virtue of counting net adds and beginning to look at the new connectivity, the new service revenues that are layered on top of this.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

You talked briefly there about the move to family plans and data buckets.



Randall Stephenson - AT&T Inc. - Chairman, CEO & President

You said family plans.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Well, let's -- just think about buckets of data for a second.

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

What you implied, I think everybody would agree, that longer term, in order to drive usage, you're not going to have a separate subscription for every device.

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

But in the short term, how do you craft a plan that avoids the near-term dilution of two or three \$20 plans getting converged into one \$50 plan?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes. So that's going to be the art. And I think we as an industry work through these things constantly, right? And I think we -- I think our company, we've gotten pretty good at managing our way through these transitions. And that's what I am most focused on is not per se family plans; what we are most focused on is connecting the next device. And particularly, where there has been an aversion or a reluctance to take those devices onto the network. So can you create something that makes that an effortless experience, to bring that device onto the network without adding another subscription? Then it's all incremental upside revenue. It's not a lot of cannibalization of existing revenues. That's the path we are pursuing.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Do you think there is a one-time hiccup to get there, or do you think you manage that smoothly enough that there's no one-time hiccup when you first move to the plan?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I don't know. We are early in an evaluation, but it seems to me when you have that large a base of these that are sitting out there and not utilizing the network, and they are sitting in place, being utilized by the customer, but not accessing the network -- if you make that simple, it seems to me it's a lift. It's not a deterioration.



Craig Moffett - Sanford C. Bernstein & Co. - Analyst

One other outcome that I can imagine from that kind of a pricing plan is that you reduce the amount of breakage, if you will -- that is, the unused minutes or the unused megabytes per month, simply statistically floating them into single plans is going to reduce that, and you're going to have higher network utilization for the same revenue. Is that a reasonable expectation?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

What you've been seeing is that your term breakage has been really quickly evaporating. So \$30 data plans of breakage is going down rather significantly, and that's the reason you get to a tiered data pricing, right? So that you can begin to monetize the utilization that goes over those levels. And so this may accelerate that a little more, but you're seeing that evaporate pretty quickly anyway.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

One other topic that's -- as I think about what's embedded in data, a few weeks ago at the Milken conference, you talked about Apple's iMessage and other free texting services -- one of the things that keep you awake at night. Talk about that.

Is that -- how big of a threat is that? And how do you mitigate the transition from very high-value, low-bandwidth services like voice and text to high-volume, low-price services like data?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

So again, the more we think things are different, the more they are really the same. I mean we go through all of these transitions every time you take any technology to IP. We saw it on the fixed line side.

And you'll see it play itself out on the wireless side. The wireless business becomes largely a data business, and so when you think about texting, text messaging, there is a threat from over-the-top messaging capabilities, and I kind of accept that. That's just a reality. It's not going to be as dramatic in the US as what you've seen in Europe, because the US has moved so aggressively to all-you-can-eat type plans for texting, and so the cost per message in the US is rather nominal. So the substitutional -- substitutionary incentives are much lower than what you'll see in Europe.

But I think over time you see kind of the service revenue model migrate, and you're seeing that happen today. You're seeing more and more of the revenues move off of voice and move on to data, and you'll see the same thing with texting. And so the objective will be, can you monetize the data utilization? And I think you're seeing that play itself out right now.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

How far are we away from only having a single data price and everything else being bundled into that price?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

You know, I'll be surprised if in the next -- I'll give you my outside view. I'll be surprised if in the next 24 months we don't see people in the marketplace with data only plans. I just think that's inevitable, right? It took a while for the fixed line business to get there, but ultimately it did, and I think we've all been able to monetize the data side of the fixed line business quite well. And so you'll see the same thing happen.

I don't think you're going to see a big flash cut in the wireless business; I think it will take time. But you'll begin to see those propagate into the marketplace.



Craig Moffett - Sanford C. Bernstein & Co. - Analyst

One of the more interesting models you've floated recently is reverse billing -- a sort of 800-number service for data. Is that for the people who may not have heard it -- was a model where various service provider, Internet companies, for example, could allow customers to sample services without it counting against a customer's usage caps.

What sort of feedback -- I mean, my sense was that you were in some ways sort of floating a trial balloon to test what kind of reaction that idea would get. What kind of feedback and what kind of reaction has it gotten?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

You know, I've been forecasting this for a long time, and again, the more things change, the more they are the same. The old MCI guy, right? I mean, you remember what caused long-distance to scale and price per minute to drop like a rock; it's when Sears and Roebuck said, look, if you help the customer get to me, I'll pay for the long-distance, right? And that really is what scaled long-distance businesses and allowed prices to decline.

I've said all along in the mobile data and in the fixed line data side, there is going to grow to be a demand for those kind of services from the same standpoint.

And think about in the mobile world, what we've talked about here. Customers are beginning to understand that as you use more, you pay for more. Right? So customers, just because it's capacity constrained, are using less. On an incremental basis, they are using less.

Now, if you're out there trying to monetize mobile data in some fashion -- you know, if you have some content and you need people coming to you to monetize it, and if the customer is now apprehensive, can you envision where that content provider may want to come to a carrier and say, look, we'd like to engage in a model where, okay, the customer isn't willing to pay, but we are willing to pay for it?

I think you'd be stunned if we weren't getting those phone calls. And we are getting those phone calls. So the content guys are the ones that are asking for this.

It's not us going out there, saying, we are going to mandate on the world, this. The content guys are coming and asking for it. So I think we as an industry are going to have to decide how do we work with that model, how do we make that work? Because at the end of the day, if you don't allow those kind of models to flourish, you're going to inhibit the potential of these services and these networks. Because the consumer is inherently going to use more -- or inherently going to use less by virtue of the pricing model.

If you're not going to let the content guys come in and participate, then you're going to try to scale it all in the back of the consumer end-user pricing. That has been proven in our industry not to be the most elegant model for scaling technologies and driving investment.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And you think we might see some experimentation with those kinds of business models in the next 12 months?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Oh, sure. Yes. I'd be surprised if we don't.



Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Now let's talk about what I think everybody is talking about in wireless these days, and it's handset subsidies. The questions, certainly, that I get, about what's been characterized as subsidy discipline -- I think it's fair to say is now the key topic of discussion -- it seems like both you and Verizon are trying to step back from the brink of both the size of subsidies and the duration or the frequency of handset replacement. Talk about those two things in order; first, how much do you think you can reduce the frequency of handset upgrades?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

These are all part of the same symptom we've been talking about on pricing. I mean it's -- you keep going back -- you're capacity constrained. And so in a capacity-constrained environment, when you move somebody to a smartphone, it's inherently going to cost more for somebody to move to a smartphone. It's not necessarily just an effort to drive down subsidies; it's just a basic economic reaction to a capacity-constrained environment.

And so the industry has basically been moving in this direction. And so you have seen the pace at which people are migrating smartphones slow a bit, and I think that's just natural. I can't give you a number in terms of what I think that does very mathematically to the number, but it inherently has to slow it.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And what about the other side of it, the size of the subsidy? What do you think happens to subsidies from here? Are customers going to bear more of the cost, or do you simply let -- do you expect ASPs to come down to reduce subsidies?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I think it will be all of the above. I mean, you're going to witness, I believe, in the next couple of years, a significant change in how you think about the network provider, the app provider, and the device provider. And what's going to drive this are a couple of things.

You're having a situation where LTE is coming fast. And the more -- I mean, I've been all over the US this week, and everywhere I've been, our LTE network is up. It's robust. It's operating great, and I'm getting really excited about it, the more that I'm using it from location to location because low latency, high-bandwidth -- combine that with the cloud. And you're going to get to an environment -- I am convinced of this -- where more and more of the content is going to move off of that device and into the cloud. So less of the content is going to be resident on the device. Now, that's really, really important, because the more that transpires, the less dependent or the less attached the consumer is to a particular device or a particular OS.

Now, add to that one other variable that's coming quickly, and that's HTML 5. And as you bring HTML 5 into the marketplace, and this is happening quickly, and the application guys are demanding this. They want this very, very badly, and they are moving here very, very quickly.

As you bring HTML 5 into it, suddenly, it becomes more about the network; it becomes more about the application, and less and less about what OS you choose or what device you choose. And so I think that by itself is going to change the model that you're referencing over the next couple of years more than anything, because what it will do is drive down the cost points for the devices. The consumer can be a little more agnostic about which device they want, and so, therefore, it just drives inherently the cost down.

Now, there are still going to be a lot of customers -- I love Apple devices. I will probably carry an Apple device for a long time. So there's always going to be a large set of customers that want Apple, some who are going to want a particular HTC device. But I think broadly, over time, that attachment to a specific device wanes. That drives the cost points down.



Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Do you think we will have three robust operating systems -- Android, Windows, and Apple?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I think two years from now we are not going to be spending a lot of time talking about OSes. I think HTML 5 renders that less and less relevant. It just -- it becomes less of an OS environment and more just of an application provider environment.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And let's stay with Apple for a second. Yesterday, Leap Wireless announced the first prepaid iPhone. Their package is about an upfront \$500 for a 4S. So, call it another extra \$300 for -- depending on the model, upfront, but \$50 or \$60 savings per month. So the payback for that is not bad for a customer.

Talk about what that does to your business. Their volume projections are not particularly high. Is that appropriate, do you think? Is that going to resonate with customers, or --?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I think that's consistent, Craig, with our experience. And the customer's appetite, or let's call it elasticity of demand, is really, really high on these devices. And moving the entry point by \$100 -- you guys watch it. You model it out as well as anybody. You move the entry point to this by \$100 upfront cost, it has a dramatic effect on demand. So we are going to watch it. I think the whole industry is going to watch it. I think it's an interesting model, and I think it's one that is going to capture a lot of our attention, but I don't envision that it's going to be a real high runner. But is there a market there? There probably is a market there.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

If there is, is there a way that you would experiment with it and say --

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Well, sure.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Obviously, you could do the same thing and subsidize less and charge less as well. Is that something that we might see from AT&T?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

We effectively have that in the market now, but you -- it wouldn't really be a competitor to what Leap has. But yes, I think if there proves to be some demand that we have missed here, absolutely, it's something we would look at. I'm not adverse to the model; I kind of like a low subsidy model and a lower ARPU. I think that's a good model.



Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Now let's transition to the wireline business for a second. You've gone on record, and you reduced your exposure to directories already, but you've gone on record talking about the possibility of divestitures. Where are we with the idea of divestitures? Is it still something you're exploring? And you've said that it's tied to your ability to upgrade the physical infrastructure to higher-speed broadband has. Has there been any changes with vectoring and that sort of thing that change that calculus?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

That's the key variable for me. And I've said from the beginning that our objective -- when we think about -- it's roughly 20 million lines, let's call them, using really rough math, where we don't have what I'll call a U-verse capable solution, a really good, high-bandwidth, fixed-line solution into homes and businesses. And so the objective has been can we find a high-bandwidth solution to get into these locations for them to be competitive? And then if you can't find that, then you probably want to look at options of selling or disposing of those. So priority one has been, is there a solution?

One of the best parts -- I guess one of the most upside aspects of the T-Mobile deal was it gave us an LTE solution to take to all of these locations. So set that aside; I don't have a wireless solution, so we are looking at what are the other fixed-line solutions.

And over the last -- I think it's been roughly 18 months, we have been deploying IP-DSLAM into a lot of our locations. And you know, we are getting some very good indications. Our business plan modeling -- we've missed it on the cost to deploy. We missed it -- it's coming in lower than we were anticipating.

The take rate has been higher than we were anticipating. The ARPU has been higher than we were anticipating. So it's causing us to pause. And to your point, vectoring and pair bonding and so forth -- what kind of runway do you have to really getting -- I think you're going to have to be 20 mg to 30 mg at least in the short run to have a competitive product. And so we are seeing line of sight to that, so we are trying to flush this out and see if there really is a model here to go much deeper in those 20 million lines with this technology.

And I mean I don't know -- I'm cautiously optimistic that maybe we have a solution here. And so we're going to flush this out in the next three, four months. Second half of the year, we're going to come to closure on this.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

So the vectoring -- I just saw a -- the newest Cisco data that came -- out that suggests that the average speed of a terrestrial broadband in their estimate by 2016 will be 34 megabits per second. That's faster than U-verse is rated for today, even if we took out all of the video component and moved it all to broadband, it's still typically rated for 25 megabits without bonding and vectoring.

How fast can U-verse -- what can it get you to? And has your view changed at all about the long-term competitiveness of U-verse if I think five, six, 10 years out?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

No. I've stopped chasing Cisco forecasts on all of this, because -- what we are finding in the marketplace is -- I think we called it right, Craig. I feel really good about the decision we made with U-verse, because what we said was, priority one has to be to get to an all IP platform. Once you get to an all IP platform, then it makes the transport that you choose -- you become agnostic to what transport you choose. You put in transport that meets the market demand.

And so I do believe in the next five years there are going to be places where we need much higher bandwidth than what we have today. In those specific places, if we have to go Fiber-to-the-Premise in business locations, we can do that. It doesn't require us to fundamentally change out

anything else; we just go deeper than where we are with fiber. We may need to take fiber deeper into a neighborhood and not necessarily to a house to meet the competitive requirements.

And so this is playing itself out today. We are doing this in certain areas now. And to the extent we get pair bonding and we get improved vectoring and so forth, and it's -- you know, we have in the labs -- this stuff is up and running at 100 megabits. And we're getting in some locations 40 and 50 megabits. And so I'm not -- I don't lose sleep at night worrying about is the bandwidth requirements going to outpace what we need to do? Because I don't think it's going to be a ubiquitous thing.

These 20 million access lines we are talking about -- I think for a long time, 20 megabits to 30 megabits is going to be very, very competitive, and may actually set a mark for a period of time. Because there's not a lot of what I call upgraded cable in many of these locations.

And so bottom line, I like where we are. It's going to always drive additional investment in certain niche areas. We can be selective where we go deeper with fiber, but I think there's a lot of options that will keep enhancing the bandwidth and the throughput.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And one last question about this divestitures concept. In the places where you would look at divestitures, is it reasonable to think that you can sell off small pieces of individual states, or often it's been the case that the public service commissions in the states will say, you know, you can't leave our rural regions behind, so it becomes all or nothing?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

I would say in terms of selling, spinning, spin-merging assets, the regulatory issues are the most difficult to deal with. It's more than finding a buyer; it's more than the operational aspects. The regulatory issues are the most difficult to deal with and to decide how you want to effectuate this. So that is obviously a big hurdle. You sit out there and you look at how do you get this done from a regulatory standpoint? Because the fact of the matter is, these 20 million lines -- they represent over 80% of our geography.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

By square mileage, you mean?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes, by square mileage, exactly. So it's not like you can just go out and carve out one piece and take care of the lion's share of these. They are scattered. They are all over the place.

And so you've got to think about if you are going to do a sale and you want to do something meaningful, it's going to cover multiple states, which is going to mean multiple approvals, which is going to mean a significant amount of time and so forth. So we're working that, but that's the part that's causing you just to pause in terms of the willingness to take something like that on.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

So a hard thing to do. Now let's go back to the business market that we talked about. Fair to say that the enterprise market has been seeing a couple of different trends going on.

One is this downward pressure and pricing conversions from legacy services to IP services. A second is the rapid growth of IP consumption and growth from that lower base. And then the third is simply what you called the seats problem and the downward pressure on revenues from the economy. How are those three things playing out right now in the enterprise segment, and what's your outlook for the enterprise business?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

The enterprise business -- it's catching momentum, and I'm hopeful that the economy doesn't cause this to slow down some, but we've had a good trajectory on business in spite of what I would call lagging employment and just lagging economic indicators. And it's been driven by the migration that you're talking about.

So think about where the growth aspects of the business are in IP. So managed VPN services, and Ethernet -- Ethernet is proving to be a rather dramatic grower for not only connecting cell sites, but businesses wanting Ethernet connectivity directly, and hosting, and so forth. You put all those together now -- we call them strategic services, but it's really just very specifically some IP-related services that we've invested a lot in. These are now running at about a \$6 million a year annual run rate, and they have been consistently growing, you know, 15% to 20% -- closer to 20%. Last quarter they grew at 19%. And they're not showing any indication of slowing.

And so then you layer that, and you kind of lay it up against the legacy product set. And the legacy product set is getting less and less relevant all the time. In fact, total voice, which I'll call legacy voice, is now well less than 20% of our overall revenues. And so we're getting to a place where the growth in the IP services is now outpacing the decline in legacy services, and as the legacies kind of hit this asymptote -- you know, their rate of decline will slow, we believe.

And so we think we have good line of sight to growing enterprise business here in the future; in fact, I will be terribly disappointed if we don't get enterprise business revenues growing this year. It's on pace to do that, and I see no reason why we shouldn't have it growing this year.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Well, that's a business with very high operating leverage, so --

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes, exactly.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

So to the extent that you get enterprise -- you said historically that wireline margins are going to be flat to trending upward over time. Is that still your view? And if I think in sort of near term, medium term, long term, what is the trajectory of wireline margins look like?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Yes, the objective internally is obviously to grow these margins. And I really believe that we have -- to your point, the leverage and the capability to do this.

We have demonstrated over the last four or five years a real knack at just continuing to pull significant blocks of cost out of the business -- our One AT&T initiatives. You know it's -- we are pulling those out in \$1 billion a year blocks.

And what that's allowed us to do is while we are scaling these new services, which they are not really margin rich in the early years, as you know, but what it has allowed us to do is while we are scaling those and the legacy products, which are high margin or declining, we've been able to keep margins flat while we've made this transition.

So now we're getting to a place where I have no doubt that we'll continue to get the productivity benefits that you've seen us get over the last four or five years. But now these IP services are starting to grow, and we are getting the leverage and the scale benefits from them. In our business, that's a beautiful thing.

Once you begin to scale these, they scale very nicely. And so you put the elements together -- we ought to be able to expand margins over the foreseeable future. There's no reason we shouldn't.

And if you look on the consumer side, the fight is -- the legacy voice declining, on the increment, those are really high margin products, but U-verse -- we are hitting that place where the churn is going down. We are getting the scale benefits, we are getting the content scale benefits, and so those margins are expanding. And so you put it all together -- this ought to be a staple -- worst case, a stable margin story. I think we can expand margins.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And a last question here on the wireline side of the business -- can you update us on the state of your labor negotiations? And also a related question, I guess, is with interest rates coming down so rapidly, what does that mean for your pension obligations and potential pension contributions for this year?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

So labor negotiations -- the talks are ongoing. They are very active right now. In fact, the teams -- I was involved last night. And I think the discussions are in a -- still a very productive stage. It would not be a surprise to anybody to know what the issues are. It's the legacy benefit costs, both healthcare as well as pension.

And I think that we as a company and our employees -- we did a lot of really good things the last bargaining round to really improve the sustainability of our current medical benefits. And so we have got to continue moving the benefit cost trajectory, and so that's what this is all about. Can we get the benefit cost structures to continue to make improvement? And the pension side -- we have to continue to restrain the growth of our pension costs.

And so I feel everybody understands it. Everybody understands the issues. So it's just going to be a very difficult, hard negotiation; I have no doubt about that. But I do think we are going to get this thing done in a reasonable timeframe.

In terms of pension contributions, I think it's -- there aren't any dramatic contribution requirements on the horizon, but I think all of us are at a place where the market returns over the last few years have put us in a place where contributions at some level are just going to be a standard part of business. And so we all lived through the '90s where we had these 130%-funded pension plans, and got spoiled to that. I think you're going to get to more of a sustainable pension contribution requirement level over time.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

And now I think -- we are running low on time, so I want to return to one of the things you said early on. You said that the opportunity for large-scale M&A may be closed [regulatorially].

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Difficult, yes.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

What about smaller scale consolidation? I think John yesterday at a different conference talked about that it's inevitable that this industry will end up consolidating -- the wireless side of the business -- will end up consolidating. How do you see that happening, and how do you see it shaping your portfolio over the next few years?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Look, the industry -- and I'm talking the wireless industry -- the industry is stressed. It really is stressed, and it's stressed because, very simplistically, there is not enough spectrum to accommodate the demands that everybody are currently experiencing. I don't think there's anybody right now immune to this. I am not aware of any wireless company sitting out there with this big block of fallow capacity that's not being utilized. So when you have an industry stressed like this, there's just an inherent gravitational pull towards consolidation.

And so I will be surprised if over -- I mean, you saw -- and I guess it was rumored that Sprint and Metro tried to combine. And I would be surprised if you don't see other attempts at consolidation in this industry. And who the participants will be, I have no idea. And what our participation it will be -- we don't comment on M&A. But I just think we would all be stunned and surprised if you didn't see attempts over the next few months.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Do you look overseas as you think about your portfolio and, say, if the opportunities for you to play a role in consolidation here in the US may be limited, are there overseas opportunities for you?

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

If those opportunities presented themselves, I mean, I've been unbashful about saying, yes, we'll take a hard look.

Right now, between trying to get -- I really want to get our capital structure aligned to a more optimal level, which means share buybacks. And it's no secret we've been buying back shares and trying to get the capital structure aligned.

The US is driving some unbelievable capital requirements on our business, and the wireless industry particularly. And so our capital allocation right now for the next two or three years is really focused on the US. And so it's not a high priority for me to go find options outside the US right now. It's basically trying to balance capital structure and the current requirements in the US is driving most of our allocation right now.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

Okay. And we're just about out of time, so let me ask you if you would leave us with a couple of thoughts to your investors in the room.

As you look across your business, what gets you most excited? What gets you the most worried? And do you still see yourself as a growth business? What's your level of confidence about the ability to continue to grow AT&T?



Randall Stephenson - AT&T Inc. - Chairman, CEO & President

So if you just -- 30,000 feet -- a couple of really important data points. I think it's critical we not lose sight of this that what's driving the top-line growth of the business today and it's these strategic services -- \$6 billion, growing 20%. U-Verse -- \$8 billion revenue stream, growing 38% in the first quarter. Mobile data has still got incredible legs. We talked about the room left still just from smartphone penetration. But that's a \$24 billion revenue stream growing at 20%.

You put all of these together -- so you put our wireless, our managed services, U-verse, put all that together. In the first quarter that represented 78% of our revenues, and that 78% -- which, by the way, you take Yellow Pages out, which we closed that sale this quarter. That's now 80% of our revenues are growing at 6%. And that legacy portion that's shrinking is -- that is declining more and more in terms of relevance.

And so all of these categories that I just described I think have incredible runway. And I think there's a good long-term horizon for us to see growth in all of these categories that I just mentioned. So I feel really, really good that the business is positioned to grow. I feel really good that in the first quarter you had that kind of growth profile and we had a clean sweep on margins. Margins across the board -- wireless, fixed line, consolidated margins across the board expanded while we are making all these investments in growth.

So that all feels right. I think the organization is operating very, very well. We've got some spectrum issues to deal with; we've got the rural issue to deal with because we have some investment opportunities there. What we've seen, what I'm getting confident in, is where we invest with IP-DSLAMs, we get growth, and so that can enhance the growth profile.

So I feel good that we can continue growing the business. I really do. I feel as good about the business right now as I have since I've had the job. And so what keeps me awake at night in that context?

The regulatory environment keeps me awake. It's kind of the sand in the gears right now. You know, the industry is a little bit stuck. And so the regulators get this, and they are working it hard. I don't mean to beat anybody up, but it just -- fact is it's kind of the sand in the gears of the industry right now, and we have got to get some grease into this process to get this moving. It's really important that we get that process moving and moving forward.

The other thing is just the economy. And this morning -- I can't tell you there are any big surprises, but it just kind of provides reinforcement to where a lot of us are, that this thing is not showing any signs of ticking up momentum, and maybe even losing a little momentum. And that's a problem for us. We have a \$60 billion revenue stream attached to the business side of the house, and that could be a lag and a drag for us. So those are the things that keep me awake at night.

Craig Moffett - Sanford C. Bernstein & Co. - Analyst

All right. Well, Randall, thank you very much. This has been a terrific discussion, and I look forward to having you back next year.

Randall Stephenson - AT&T Inc. - Chairman, CEO & President

Thanks. Good seeing you.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2012, Thomson Reuters. All Rights Reserved.