

AT&T INC.
Form 10-Q
May 07, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2008

or

Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number 1-8610

AT&T INC.

Incorporated under the laws of the State of Delaware
I.R.S. Employer Identification Number 43-1301883

175 E. Houston, San Antonio, Texas 78205
Telephone Number: (210) 821-4105

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [] No [X]

At April 30, 2008, there were 5,941 million common shares outstanding.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

AT&T INC.

CONSOLIDATED STATEMENTS OF INCOME

Dollars in millions except per share amounts

(Unaudited)

	Three months ended	
	March 31,	
	2008	2007
Operating Revenues		
Wireless service	\$ 10,605	\$ 9,070
Voice	9,693	10,455
Data	5,972	5,655
Directory	1,398	1,022
Other	3,076	2,767
Total operating revenues	30,744	28,969
Operating Expenses		
Cost of sales (exclusive of depreciation and amortization shown separately below)	11,775	11,252
Selling, general and administrative	8,086	7,437
Depreciation and amortization	4,903	5,616
Total operating expenses	24,764	24,305
Operating Income	5,980	4,664
Other Income (Expense)		
Interest expense	(865)	(873)
Equity in net income of affiliates	243	173
Other income (expense) – net	33	504
Total other income (expense)	(589)	(196)
Income Before Income Taxes	5,391	4,468
Income taxes	1,930	1,620
Net Income	\$ 3,461	\$ 2,848
Basic Earnings Per Share	\$ 0.58	\$ 0.46
Diluted Earnings Per Share	\$ 0.57	\$ 0.45
Weighted Average Number of Common Shares Outstanding – Basic (in millions)	5,997	6,224
Dividends Declared Per Common Share	\$ 0.400	\$ 0.355

See Notes to Consolidated Financial Statements.

AT&T INC.

CONSOLIDATED BALANCE SHEETS

Dollars in millions except per share amounts

	March 31, 2008 (Unaudited)	December 31, 2007
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,963	\$ 1,970
Accounts receivable – net of allowances for uncollectibles of \$1,361 and \$1,364	15,697	16,185
Prepaid expenses	1,610	1,524
Deferred income taxes	1,934	2,044
Other current assets	2,742	2,963
Total current assets	23,946	24,686
Property, plant and equipment	209,920	210,518
Less: accumulated depreciation and amortization	113,682	114,628
Property, Plant and Equipment – Net	96,238	95,890
Goodwill	70,815	70,713
Licenses	40,711	37,985
Customer Lists and Relationships - Net	13,692	14,505
Other Intangible Assets - Net	5,877	5,912
Investments in Equity Affiliates	2,578	2,270
Postemployment Benefit	17,645	17,291
Other Assets	6,697	6,392
Total Assets	\$ 278,199	\$ 275,644
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	\$ 13,301	\$ 6,860
Accounts payable and accrued liabilities	18,590	21,399
Advanced billing and customer deposits	3,677	3,571
Accrued taxes	4,186	5,027
Dividends payable	2,375	2,417
Total current liabilities	42,129	39,274
Long-Term Debt	60,189	57,255
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	25,203	24,939
Postemployment benefit obligation	24,510	24,011
Other noncurrent liabilities	13,910	14,798
Total deferred credits and other noncurrent liabilities	63,623	63,748
Stockholders' Equity		
Common shares issued (\$1 par value)	6,495	6,495
Capital in excess of par value	91,598	91,638
Retained earnings	34,311	33,297
Treasury shares (at cost)	(19,590)	(15,683)
Accumulated other comprehensive income (loss)	(556)	(380)
Total stockholders' equity	112,258	115,367
Total Liabilities and Stockholders' Equity	\$ 278,199	\$ 275,644

See Notes to Consolidated Financial Statements.

AT&T INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in millions, increase (decrease) in cash and cash equivalents
(Unaudited)

	Three months ended	
	March 31,	
	2008	2007
Operating Activities		
Net income	\$ 3,461	\$ 2,848
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,903	5,616
Undistributed earnings from investments in equity affiliates	(225)	(156)
Provision for uncollectible accounts	480	376
Deferred income tax expense	569	65
Net gain on sales of investments	(46)	-
Gain on license exchange	-	(409)
Changes in operating assets and liabilities:		
Accounts receivable	(150)	237
Other current assets	159	(748)
Accounts payable, accrued and other liabilities	(4,654)	(3,232)
Stock-based compensation tax benefit	(7)	(47)
Other - net	467	98
Total adjustments	1,496	1,800
Net Cash Provided by Operating Activities	4,957	4,648
Investing Activities		
Construction and capital expenditures		
Capital expenditures	(4,178)	(3,338)
Interest during construction	(70)	(35)
Acquisitions, net of cash acquired	(3,662)	(198)
Dispositions	47	209
Proceeds from sale of securities, net of investments	131	518
Other	33	7
Net Cash Used in Investing Activities	(7,699)	(2,837)
Financing Activities		
Net change in short-term borrowings with original maturities of three months or less	5,786	(2,989)
Issuance of long-term debt	3,972	5,924
Repayment of long-term debt	(613)	(227)
Purchase of treasury shares	(4,071)	(3,005)
Issuance of treasury shares	103	687
Dividends paid	(2,422)	(2,218)
Stock-based compensation tax benefit	7	47
Other	(27)	(84)
Net Cash Provided by (Used in) Financing Activities	2,735	(1,865)
Net decrease in cash and cash equivalents	(7)	(54)
Cash and cash equivalents beginning of year	1,970	2,418
Cash and Cash Equivalents End of Period	\$ 1,963	\$ 2,364

Cash paid during the three months ended March 31 for:

Interest	\$	1,130	\$	904
Income taxes, net of refunds	\$	2,763	\$	1,177

See Notes to Consolidated Financial Statements.

AT&T INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
Dollars and shares in millions, except per share amounts
(Unaudited)

	Three months ended March 31, 2008	
	Shares	Amount
Common Stock		
Balance at beginning of year	6,495	\$ 6,495
Balance at end of period	6,495	\$ 6,495
Capital in Excess of Par Value		
Balance at beginning of year		\$ 91,638
Issuance of shares		21
Stock based compensation		(61)
Balance at end of period		\$ 91,598
Retained Earnings		
Balance at beginning of year		\$ 33,297
Net income (\$0.57 per diluted share)		3,461
Dividends to stockholders (\$0.40 per share)		(2,380)
Other		(67)
Balance at end of period		\$ 34,311
Treasury Shares		
Balance at beginning of year	(451)	\$ (15,683)
Purchase of shares	(112)	(4,071)
Issuance of shares	7	164
Balance at end of period	(556)	\$ (19,590)
Accumulated Other Comprehensive Income, net of tax		
Balance at beginning of year		\$ (380)
Other comprehensive income (loss) (see Note 2)		(176)
Balance at end of period		\$ (556)
See Notes to Consolidated Financial Statements.		

AT&T INC.
MARCH 31, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Dollars in millions except per share amounts

NOTE 1. PREPARATION OF INTERIM FINANCIAL STATEMENTS

Basis of Presentation Throughout this document, AT&T Inc. is referred to as “AT&T,” “we” or the “Company.” The consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission that permit reduced disclosure for interim periods. We believe that these consolidated financial statements include all adjustments (consisting only of normal recurring accruals) necessary to present fairly the results for the interim periods shown. The results for the interim periods are not necessarily indicative of results for the full year. You should read this document in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The consolidated financial statements include the accounts of the Company and our majority-owned subsidiaries and affiliates. Our subsidiaries and affiliates operate in the communications services industry both domestically and internationally, providing wireless and wireline communications services and equipment, managed networking, wholesale services and directory advertising and publishing services.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Earnings from certain foreign equity investments accounted for using the equity method are included for periods ended within up to one month of our year end.

Substantially all of our available-for-sale securities are valued using quoted market prices (referred to as Level 1). Adjustments to fair value are recorded in other comprehensive income until the investment is sold (see Note 2). The fair market value of these securities was \$2,364 at March 31, 2008.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimates of probable losses and expenses. Actual results could differ from those estimates. We have reclassified certain amounts in prior-period financial statements to conform to the current period’s presentation.

Valuation and Other Adjustments In accordance with Statement of Financial Accounting Standards No. 112, “Employers’ Accounting for Postemployment Benefits,” (FAS 112) we establish obligations for expected termination benefits provided under existing plans to former or inactive employees after employment but before retirement. These benefits include severance payments, workers’ compensation, disability, medical continuation coverage and other benefits. At March 31, 2008, we had severance accruals under FAS 112 of \$472, of which \$71 were established as merger-related severance accruals. At December 31, 2007, we had severance accruals of \$127.

Included in the current liabilities reported on our consolidated balance sheet are accruals established under Emerging Issues Task Force (EITF) Issue No. 95-3, “Recognition of Liabilities in Connection with a Purchase Business Combination” (EITF 95-3). The liabilities include accruals for severance, lease terminations and equipment removal costs associated with our acquisitions of AT&T Corp., BellSouth Corporation (BellSouth) and Dobson Communications Corporation. Following is a summary of the accruals recorded under EITF 95-3 at December 31, 2007, cash payments made during 2008 and the adjustments thereto.

12/31/07	Cash	3/31/08
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	Balance	Payments	Adjustments	Balance
Severance accruals paid from:				
Company funds	\$ 540	\$ (68)	\$ 5	\$ 477
Pension and postemployment benefit plans	129	(16)	-	113
Lease terminations	425	(27)	2	400
Equipment removal and other related costs	161	(6)	(5)	150
Total	\$ 1,255	\$ (117)	\$ 2	\$ 1,140

AT&T INC.
MARCH 31, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

New Accounting Standards

Split Dollar Life Insurance In 2007, the EITF ratified the consensus on EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (EITF 06-4) and EITF 06-10 "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" (EITF 06-10). EITF 06-4 and EITF 06-10 cover split-dollar life insurance arrangements (where the company owns and controls the policy) and provides that an employer should recognize a liability for future benefits in accordance with Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (FAS 106). These are effective for fiscal years beginning after December 15, 2007. We adopted EITF 06-4 and EITF 06-10 on January 1, 2008, recording additional postretirement liabilities of \$101 and a decrease to retained earnings of \$63.

FAS 161 In 2008, the 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. FAS 161 will not have an impact on our financial position and results of operations.

NOTE 2. COMPREHENSIVE INCOME

The components of our comprehensive income for the three months ended March 31, 2008 and 2007 include net income, adjustments to stockholders' equity for the foreign currency translation adjustment, net unrealized gain (loss) on available-for-sale securities, net unrealized gain (loss) on cash flow hedges and defined benefit postretirement plans. The foreign currency translation adjustment was due to exchange rate fluctuations in our foreign affiliates' local currencies and the reclassification adjustment on cash flow hedges was due to the amortization of losses from our interest rate forward contracts.

Following is our comprehensive income:

	Three months ended March 31,	
	2008	2007
Net income	\$ 3,461	\$ 2,848
Other comprehensive income, net of tax:		
Foreign currency translation adjustment	66	(26)
Net unrealized gains (losses) on securities:		
Unrealized gains (losses)	(90)	81
Less reclassification adjustment realized in net income	(50)	-
Net unrealized gains (losses) on cash flow hedges:		
Unrealized gains (losses)	(78)	(23)
Reclassification adjustment for losses on cash flow hedges included in net income	4	4
Defined benefit postretirement plans:		
Amortization of net actuarial (gain) loss and prior service benefit included in net income	(28)	48
Other	-	(2)
Other comprehensive income (loss)	(176)	82

Total Comprehensive Income	\$ 3,285	\$ 2,930
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AT&T INC.
MARCH 31, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

NOTE 3. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic and diluted earnings per share for the three months ended March 31, 2008 and 2007 is shown in the table below:

	Three months ended	
	March 31,	
	2008	2007
Numerators		
Numerator for basic earnings per share:		
Net income	\$ 3,461	\$ 2,848
Dilutive potential common shares:		
Other stock-based compensation	2	2
Numerator for diluted earnings per share	\$ 3,463	\$ 2,850
Denominators (000,000)		
Denominator for basic earnings per share:		
Weighted-average number of common shares outstanding	5,997	6,224
Dilutive potential common shares:		
Stock options	14	22
Other stock-based compensation	22	20
Denominator for diluted earnings per share	6,033	6,266
Basic earnings per share	\$ 0.58	\$ 0.46
Diluted earnings per share	\$ 0.57	\$ 0.45

At March 31, 2008 and 2007, we had issued and outstanding options to purchase approximately 223 and 281 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 116 and 132 million shares exceeded the average market price of AT&T stock for the three months ended March 31, 2008 and 2007. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective periods. At March 31, 2008, the exercise price of 108 million share options was below market price.

AT&T INC.
MARCH 31, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. We analyze our various operating segments based on segment income before income taxes. Interest expense and other income (expense) – net are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in the calculation of each segment's percentage of our consolidated results. We have four reportable segments: (1) wireless, (2) wireline, (3) advertising & publishing and (4) other.

The wireless segment provides wireless voice, data and other communications services.

The wireline segment provides landline communications services, including local and long-distance voice, switched access, Internet protocol and Internet access data, messaging services, managed networking to business customers, AT&T U-verseSM TV service (U-verse) and satellite television services through our agency arrangements.

The advertising & publishing segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. Results for this segment are shown under the amortization method, which means that revenues and direct expenses are recognized ratably over the life of the directory title, typically 12 months. However, consolidated results for 2007 directory operations acquired in our BellSouth acquisition are treated differently in accordance with Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141).

Under FAS 141, BellSouth deferred revenue and expenses from directories published during the twelve-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 revenue of \$409 and expenses of \$108 in the first quarter of 2007. These amounts are eliminated in the consolidations and eliminations column in the reconciliation below.

The other segment includes results from Sterling Commerce Inc., customer information services and all corporate and other operations. This segment includes our portion of the results from our international equity investments. Also included in the other segment are impacts of corporate wide decisions for which the individual operating segments are not being evaluated.

In the following tables, we show how our segment results are reconciled to our consolidated results reported in accordance with GAAP. The Wireless, Wireline, Advertising & Publishing and Other columns represent the segment results of each such operating segment. The Consolidation and Elimination column adds in those line items that we manage on a consolidated basis only: interest expense and other income (expense) – net. This column also eliminates any intercompany transactions included in each segment's results as well as the advertising & publishing revenue and expenses in the first quarter of 2007 as noted above.

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AT&T INC.
MARCH 31, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

At March 31, 2008 or for the three months ended

	Wireless	Wireline	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	\$ 11,785	\$ 17,087	\$ 1,398	\$ 474	\$ -	\$ 30,744
Intersegment revenues	40	537	19	70	(666)	-
Total segment operating revenues	11,825	17,624	1,417	544	(666)	30,744
Operations and support expenses	7,389	11,621	787	730	(666)	19,861
Depreciation and amortization expenses	1,480	3,170	212	40	1	4,903
Total segment operating expenses	8,869	14,791	999	770	(665)	24,764
Segment operating income (loss)	2,956	2,833	418	(226)	(1)	5,980
Interest expense	-	-	-	-	865	865
Equity in net income of affiliates	2	-	-	241	-	243
Minority interest	(60)	-	-	-	60	-
Other income (expense) – net	-	-	-	-	33	33
Segment income before income taxes	\$ 2,898	\$ 2,833	\$ 418	\$ 15	\$ (773)	\$ 5,391
Segment Assets	\$ 118,743	\$ 172,103	\$ 14,212	\$ 202,373	\$ (229,232)	\$ 278,199

For the three months ended March 31, 2007

	Wireless	Wireline	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	\$ 9,975	\$ 17,476	\$ 1,431	\$ 496	\$ (409)	\$ 28,969
Intersegment revenues	22	510	12	48	(592)	-
Total segment operating revenues	9,997	17,986	1,443	544	(1,001)	28,969
Operations and support expenses	6,583	11,651	734	421	(700)	18,689
	1,891	3,440	242	43	-	5,616

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Depreciation and amortization expenses							
Total segment operating expenses	8,474	15,091	976	464	(700)	24,305	
Segment operating income	1,523	2,895	467	80	(301)	4,664	
Interest expense	-	-	-	-	873	873	
Equity in net income of affiliates	7	-	-	172	(6)	173	
Minority interest	(48)	-	-	-	48	-	
Other income (expense) – net	-	-	-	-	504	504	
Segment income before income taxes	\$ 1,482	\$ 2,895	\$ 467	\$ 252	\$ (628)	\$ 4,468	

AT&T INC.
MARCH 31, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

NOTE 5. PENSION AND POSTRETIREMENT BENEFITS

Substantially all of our employees are covered by one of various noncontributory pension and death benefit plans. We also provide certain medical, dental and life insurance benefits to substantially all retirees under various plans and accrue actuarially determined postretirement benefit costs as employees earn these benefits. Our objective in funding these plans, in combination with the standards of the Employee Retirement Income Security Act of 1974, as amended (ERISA), is to accumulate assets sufficient to meet the plans' obligations to provide benefits to employees upon their retirement. No significant cash contributions are required under ERISA regulations during 2008.

The following details pension and postretirement benefit costs included in operating expenses (in cost of sales and selling, general and administrative expenses) in the accompanying Consolidated Statements of Income. We account for these costs in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" and FAS 106. In the following table, gains are denoted with parentheses and losses are not.

	Three months ended March 31,	
	2008	2007
Pension (benefit) cost:		
Service cost – benefits earned during the period	\$ 293	\$ 316
Interest cost on projected benefit obligation	830	801
Expected return on assets	(1,400)	(1,367)
Amortization of prior service cost	33	32
Recognized actuarial loss	2	60
Net pension (benefit) cost	\$ (242)	\$ (158)
Postretirement benefits cost:		
Service cost – benefits earned during the period	\$ 107	\$ 127
Interest cost on accumulated postretirement benefit obligation	636	643
Expected return on assets	(332)	(337)
Amortization of prior service benefit and transition obligation	(90)	(89)
Recognized actuarial loss	-	74
Postretirement benefits cost	\$ 321	\$ 418
Combined net pension and postretirement cost	\$ 79	\$ 260

Our combined net pension and postretirement cost decreased \$181 in the first quarter of 2008. This decrease was primarily due to the decrease in amortization of the unrecognized actuarial losses recorded under Statement of Financial Standards No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" in Other Comprehensive Income. As allowed under GAAP, we amortize gains and losses only when the net gains or losses exceed 10 percent of the greater of the projected benefit obligation or the market-related value of assets.

We have varying types of pension programs providing benefits for certain non-U.S. operations. In addition to the pension and postretirement costs above, we recorded net pension cost for non-U.S. plans of \$4 in the first quarter of

2008 and 2007.

We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. Net supplemental retirement pension benefits cost, which is not included in the table above was \$45 in the first quarter of 2008 and \$47 in the first quarter of 2007, of which \$35 and \$36 was interest cost, respectively.

AT&T INC.
MARCH 31, 2008

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Dollars in millions except per share amounts

RESULTS OF OPERATIONS

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 in both the United States and internationally providing telecommunications services and equipment as well as directory advertising and publishing services. You should read this discussion in conjunction with the consolidated financial statements, accompanying notes and management’s discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the year ended December 31, 2007. In the tables throughout this section, percentage increases and decreases that are not considered meaningful are denoted with a dash.

Consolidated Results Our financial results in the first quarter of 2008 and 2007 are summarized as follows:

	First Quarter		Percent Change
	2008	2007	
Operating revenues	\$ 30,744	\$ 28,969	6.1%
Operating expenses	24,764	24,305	1.9
Operating income	5,980	4,664	28.2
Income before income taxes	5,391	4,468	20.7
Net Income	3,461	2,848	21.5%

Overview

Operating income Our operating income increased \$1,316, or 28.2%, in the first quarter of 2008, reflecting increased wireless service revenues and continued growth in data revenues. Our operating income margin increased from 16.1% to 19.5%. Reported results in 2008 include directory revenue and expenses from directories published by subsidiaries acquired in our 2006 acquisition of BellSouth Corporation (BellSouth). In accordance with U.S. generally accepted accounting principles (GAAP), our reported results in the first quarter of 2007 did not include deferred revenue of \$409 and expenses of \$108 from these directories published during the 12-month period ending with the December 29, 2006 acquisition date. Had our first-quarter 2007 directory results included this deferred revenue and expenses, operating income would have increased \$1,015 in the first quarter of 2008. See our “Advertising & Publishing Segment Results” section for discussion of this purchase accounting treatment.

Operating revenues Our operating revenues increased \$1,775, or 6.1%, in the first quarter primarily due to continuing growth in wireless subscriber revenues and data revenues, primarily related to Internet Protocol (IP) data, partially offset by the continued decline in voice revenues. As previously discussed, purchase accounting treatment for directories published 12 months prior to the BellSouth acquisition also contributed to the increased revenues in the first quarter of 2008 when compared to 2007.

Our operating revenues also reflect the continued decline of our retail access lines due to increased competition, as customers disconnected both primary and additional lines and switched to competitors’ wireless, Voice over Internet Protocol (VoIP) and cable offerings for voice and data. While we lose the voice revenues, we have the opportunity to increase wireless service revenues should the customer choose us as their wireless provider.

Operating expenses Our operating expenses increased \$459, or 1.9%, in the first quarter primarily due to increased wireless equipment sales, a \$374 charge taken in the first quarter of 2008 for workforce reductions and our accounting for the deferred directory expenses noted above. Partially offsetting these increases were approximately \$200 of merger integration costs recognized in 2007 and not in 2008, and lower amortization expense on intangible assets in 2008. We are primarily amortizing these intangibles using an accelerated method, which means that we record lower expenses as the remaining useful life of the asset decreases.

Interest expense decreased \$8, or 0.9%, in the first quarter of 2008. Interest expense remained relatively unchanged due to a decrease in our weighted average interest rate and changes in interest charged during construction offset by an increase in our average debt balances. Future interest expense will reflect interest during construction due to our spectrum purchases (see “Wireless Spectrum Auction” discussed in “Other Business Matters”).

AT&T INC.
MARCH 31, 2008

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Continued
Dollars in millions except per share amounts

Equity in net income of affiliates increased \$70, or 40.5%, in the first quarter of 2008 primarily due to improved results from our investment at América Móvil S.A. de C.V. (América Móvil) and other accounting related adjustments at Teléfonos de México, S.A. de C.V. (Telmex).

Other income (expense) – net We had other income of \$33 in the first quarter of 2008 and \$504 in the first quarter of 2007. Results in the first quarter of 2008 consisted of a net gain on the sale of cost investments, interest income, minority interest and other non-strategic investment activity. Results in the first quarter of 2007 primarily consisted of gains of \$409 related to a wireless spectrum license exchange and \$85 for land dispositions and leveraged lease sales, which were partially offset by \$41 in minority interest expenses.

Income taxes increased \$310, or 19.1%, in the first quarter of 2008. The increase was primarily the result of higher income before income taxes in 2008. Our effective tax rate was 35.8% in the first quarter of 2008 and 36.3% for the same period in 2007. The decrease in our effective tax rate in 2008 was due to the recognition of state tax benefits and other adjustments.

Selected Financial and Operating Data

	March 31,	
	2008	2007
Wireless customers (000)	71,367	62,217
Consumer revenue connections (000) 1,2	49,340	49,265
Network access lines in service (000) 2	60,415	65,429
Broadband connections (000) 2,3	14,647	12,861
Video connections (000) 2,4	2,611	1,697
Debt ratio 5	39.6%	35.4%
Ratio of earnings to fixed charges	5.5	5.4
Number of AT&T employees	310,070	301,760

1 Consumer revenue connections includes retail access lines, VoIP customers, broadband and video.

2 Represents services by AT&T's local exchange companies (ILECs) and affiliates.

3 Broadband connections include DSL, U-verse high-speed Internet access and satellite broadband.

4 Video connections include customers that have satellite service under our agency arrangements and U-verse video connections.

5 See our "Liquidity and Capital Resources" section for discussion.

Segment Results

Our segments represent strategic business units that offer different products and services and are managed accordingly. 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. Interest expense and other income (expense) – net are managed only on a total company basis and are, accordingly, reflected only in consolidated results. We have four reportable segments: (1) wireless; (2) wireline; (3) advertising & publishing; and (4) other.

The wireless segment provides voice, data and other communications services.

The wireline segment provides landline communications services, including local and long-distance voice, switched access, IP and Internet access data, managed network services, AT&T U-verseSM TV services (U-verse) and satellite television services through our agency arrangements.

The advertising & publishing segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising.

The other segment includes results from Sterling Commerce Inc. (Sterling), customer information services and all corporate and other operations. The other segment includes our portion of the results from our international equity investments.

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The following tables show components of results of operations by segment. Significant segment results are discussed following each table. Capital expenditures for each segment are discussed in "Liquidity and Capital Resources."

Wireless
Segment Results

	First Quarter		Percent Change
	2008	2007	
Segment operating revenues			
Service	\$ 10,645	\$ 9,092	17.1%
Equipment	1,180	905	30.4
Total Segment Operating Revenues	11,825	9,997	18.3
Segment operating expenses			
Cost of services and equipment sales	4,110	3,670	12.0
Selling, general and administrative	3,279	2,913	12.6
Depreciation and amortization	1,480	1,891	(21.7)
Total Segment Operating Expenses	8,869	8,474	4.7
Segment Operating Income	2,956	1,523	94.1
Equity in Net Income of Affiliates	2	7	(71.4)
Minority Interest 1	(60)	(48)	(25.0)
Segment Income	\$ 2,898	\$ 1,482	95.5%

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

Operating Income and Margin Trends

Our wireless segment operating income increased \$1,433, or 94.1%, in the first quarter of 2008 and our wireless segment operating income margin increased from 15.2% in the first quarter of 2007 to 25.0% in the first quarter of 2008. The higher margin in 2008 was primarily due to revenue growth of \$1,828, or 18.3%, partially offset by increased operating expenses of \$395, or 4.7%, reflecting network and operational improvements. The majority of the improvement in our results was due to the increase in our customer base of 9.2 million since March 31, 2007. This increase includes 1.7 million customers related to our acquisition of Dobson Communications Corporation (Dobson), which was acquired in November 2007. As of March 31, 2008, we served 71.4 million wireless customers, compared to 62.2 million at March 31, 2007. Contributing to our net additions was improvement in the postpaid customer turnover (churn) rate due to our strong network performance and attractive products and services offerings. First quarter customer net additions were adversely affected by approximately 330,000 disconnections related to the shut down of our Time Division Multiple Access (TDMA) wireless network operations, which was completed in February 2008. Additionally, gross customer additions increased to 5.0 million in the first quarter of 2008, compared to 4.3 million in the first quarter of 2007.

Also contributing to our improved results were higher average service revenue per user/customer (ARPU) and effective churn management, as well as success in achieving merger synergies and operational efficiencies. ARPU increased 2.0% in the first quarter of 2008, primarily related to data services ARPU growth of 37.1%. We expect continued growth from data services as more customers purchase advanced and integrated handsets 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 4.7% in the first quarter of 2008, reflecting a higher percentage of prepaid and reseller customers,

which provide lower ARPU than postpaid customers. We expect continued pressure on voice service ARPU. Results also benefited from merger integration costs recognized in 2007 and not reoccurring in 2008, and lower amortization expense on intangible assets in 2008.

Our total churn rate remained stable and was 1.7% in the first quarter of 2008 and 2007. Our postpaid churn rate declined to 1.2% compared to 1.3% in the first quarter of 2007. We expect the increasing mix of prepaid customers in our customer base will continue to pressure overall churn rates.

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Operating Results

Service revenues are comprised of voice, data and other revenue. Service revenues increased \$1,553, or 17.1%, in the first quarter of 2008 and primarily consisted of:

- Data revenue increases of \$835, or 57.3%, in the first quarter primarily due to the increased number of data users and an increase in data ARPU of 37.1%, which primarily resulted from increased use of more advanced and integrated handsets, which provide for text messaging, Internet access, e-mail, other data services and media bundling services. Data service revenues represented 21.5% of wireless service revenues in the first quarter of 2008 and 16.0% in the first quarter of 2007.
- Voice and other revenue increases of \$718, or 9.4%, in the first quarter primarily due to an increase in the average number of wireless customers of 14.8%, partially offset by a decline in voice ARPU of 4.7%. Included in voice revenues were increases in long-distance and net roaming revenue due to increased international usage and a positive impact from the acquisition of Dobson.

Equipment revenues increased \$275, or 30.4%, in the first quarter of 2008. The increase was due to higher handset revenues reflecting increased retail customer gross additions of 14.7% and customer upgrades to more advanced integrated handsets.

Cost of services and equipment sales expenses increased \$440, or 12.0%, in the first quarter of 2008 primarily due to increased equipment sales expense of \$425 due to the overall increase in sales as well as an increase in sales of higher-cost, advanced and integrated handsets and accessories. Total equipment costs continue to be higher than equipment revenues due to the sale of discounted handsets to customers who committed to one-year or two-year contracts or in connection with other promotions.

Cost of services increased \$15 in the first quarter due to increased Universal Service Fund, reseller services and other expense of \$111, partially offset by a decline in expenses of \$96 primarily related to lower network costs, interconnect, roaming and long-distance expenses related to cost savings initiatives, including vendor maintenance agreements, and benefits from the Dobson acquisition. The lower cost of services also reflects our continued migration off the T-Mobile USA network in California. These declines in network expenses were partially offset by higher network usage, with increases in total system minutes of use of 15.3% and associated network system expansion and maintenance costs.

Selling, general and administrative expenses increased \$366, or 12.6%, in the first quarter and included the following:

- Increases in customer service and other expenses of \$212 primarily due to increased support costs and bad-debt expense.
- Increases in selling, upgrade commissions and residual expenses of \$154 due to increases in sales, prepaid plan gross addition costs and handset upgrade activity, which was consistent with our increase in customer gross and net additions. This increase was partially offset by a decline in advertising expenses.

Depreciation and amortization expenses decreased \$411, or 21.7%, in the first quarter of 2008. Amortization expense decreased \$246 in the first quarter primarily due to using an accelerated amortization method for customer lists, trade names and other intangible assets related to our acquisition of BellSouth's 40% ownership interest in AT&T Mobility.

Depreciation expense decreased \$165 in the first quarter primarily due to certain network assets becoming fully depreciated, partially offset by increased expense related to ongoing capital spending for network upgrades and

expansion.

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Wireline
Segment Results

	First Quarter		
	2008	2007	Percent