Operator

Ladies and gentlemen, thank you for standing by and welcome to AT&T First Quarter Earnings Release 2013 Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will be given at that time. (Operator Instructions) Also as a reminder, this teleconference is being recorded.

And at this time, we will turn the conference call over to your host; Ms. Susan Johnson. Please go ahead.

Susan A. Johnson

Thank you, Tony. Good afternoon, everyone, and welcome to our first quarter conference call. It's great to have you with us today. I'm Susan Johnson, Head of Investor Relations for AT&T. Joining me on the call today is John Stephens, AT&T's Chief Financial Officer. John will provide an update with perspectives on the quarter then we'll follow-up with questions. Let me remind you, our earnings material is available on the Investor Relations page of the AT&T website. That's www.att.com/investor.relations.

I also need to cover our Safe Harbor statement, which is on slide 2. This presentation and comments may include forward-looking statements. They're subject to risks. Results may differ materially. Details are in our SEC filings and on AT&T's website.

Now before I turn the call over to John, let me quickly cover our consolidated financial summary, which is on slide 3. Reported EPS for the quarter was $0.67 that's up more than 11% over last year's first quarter. Our results this quarter include about $0.03 help from an income tax settlement, when you exclude this earnings per share was $0.64 for about an 8.5% increase over last year's adjusted first quarter EPS of $0.59, which is adjusted to exclude our divested Ad Solutions unit.

Consolidated revenues excluding Ad Solutions were up 0.9% year-over-year. Thanks to solid revenue growth in wireless, continued gains in U-verse services and growth in strategic business services. Revenues were impacted somewhat by lower regulatory fees this quarter. When you normalize for the difference in these charges, consolidated revenue would have grown 1.3%. Consolidated margins were down slightly year-over-year primarily due to wireline pressure.

Cash flow started the year strong. Cash from operating activities for the quarter totaled $8.2 billion and free cash flow was $3.9 billion. And we continued buying back shares as part of our repurchase program. In the first quarter, we bought back 168 million shares for $5.9 billion.

With that overview, I will now turn the call over to AT&T's Chief Financial Officer, John Stephens. John?

John Stephens

Thank you, Susan and good afternoon everyone. Thank you for being with us today and as always thank you for your interest in AT&T. Before we get to the detailed results, let's start with a quick overview, highlights are on Slide 4.

First, we had a solid start to the year. Earnings per share growth was strong. Adjusted consolidated revenues increased. And cash flow continues to be a success story for us. We added more than $2 million IP broadband connections in the quarter when you combine both wireless and wireline connections.

In wireless, it's all about the mobile Internet. Data growth was strong, smartphone sales set another first quarter record. Tablet showed post-paid growth with an exceptional quarter, and customers continued to flock to our mobile share plans making it easier than ever to add new devices and drive further growth. This resulted in improved revenues, better margins, post-paid ARPU growth and lower churn.

In wireline, U-verse continues to shine. We had our best ever U-verse high speed Internet sales in the first quarter. This drove positive broadband growth. In fact, we had our best total wireline broadband growth in nine quarters. U-verse video sales also were strong, as we added more subscribers than we have in any quarter over the last two years.

So the team is executing at a high level and we have the right strategy. Our financial results were solid, our capital structure sound, all in all a solid start to the New Year.

Before we move to operational results, I'd like to give you a quick update on Project Velocity or Project VIP. Details are on slide five. It's still early, but we already have made tremendous progress with our LTE deployment. We are running ahead of schedule with nearly 200 million LTE POPs covered to date. And we expect to complete nearly 90% of our $300 million POP LTE build out by the end of this year. The LTE network also is operating at high levels. First our LTE network is the fastest in the nation that's supported by an independent third-party testing group.

Then on wireless network performance including call, text and data. RootMetrics ranked AT&T number one or tied for number one in 14 of the 23 markets they have surveyed so far this year. And this comes on top of ranking first or tied for first in more than 70% of the markets RootMetrics surveyed in the second half of last year where we had deployed LTE.

Our U-verse VIP deployments will begin rolling out later this year. But the incredible first quarter U-verse results add to our confidence in making this a larger part of our growth strategy. We had record high-speed IT broadband net adds along with increasing U-verse video games. We continue to gain market share in areas where we offer U-verse and Project VIP expands those areas even more.

The same holds true with our strategic business service revenue growth and our fiber build into business. Even in uncertain economic times, we are seeing growing demand for high-speed connectivity and our advanced dial services. These results once again are going to show that Project VIP is working and the right strategy for AT&T.

Now, let’s move to our operational results starting with wireless, where we had another solid quarter. Thanks to continued growth of the mobile Internet. Revenue and ARPU are on slide 6. Mobile data continues to surge. Revenues were up 21% in the quarter that helped drive 3.4% service revenue growth and total wireless revenues were up 3.4%. You will recall that we adjusted the way we book our data revenues which no longer include text messaging, and as you can see this quarter mobile data continues to surge. It’s now at $20 billion annualized revenue stream growing at 21%. You also can see the impact of data growth when you look at postpaid ARPU.

Data ARPU grew 18% and total postpaid phone-only ARPU was up 2%. Total postpaid ARPU, which includes high margin, but lower-ARPU tablets and other non-phone devices, also grew in the quarter, up about 1%.

Our postpaid smartphone base also continues to expand. Those details are on slide seven. Smartphone subscribers increased by more than 1.2 million in the quarter and by more than 7 million in the last 12 months. Overall smartphones now make up more than 70% of our postpaid phone base and smartphones accounted for nearly 90% of postpaid sales in the quarter, giving us even more room for smartphone growth. These are the premium subscribers in our business.

They have twice the ARPU of non-smartphone subscribers and much lower churn. So their conversion brings additional revenue. Another new first quarter smartphone sales record of 6 million helped drive that growth. We had 4.8 million iPhone activations in the quarter while our upgrade rate was steady when compared to the last year’s levels.

The number of postpaid subscribers on usage base data plans also continues to grow. Overall, almost 70% of our smartphone base has moved to usage base plans.

Mobile share plans continue to be popular by the end of the first quarter, mobile share accounts reached $3.3 million. These accounts include about $10 million subscribers or devices such as smartphones and tablets. This growth is even more impressive when you remember that we give customer the choice when picking a data plan allowing them to pick the one that works fast for them. At the same time, take rates in the higher mobile share data plans those that are 10 gigabytes or higher continue to run above expectations with more than a quarter of mobile share accounts on those plans.

And we continue to see a steady movement of subscribers on unlimited plans taking advantage of Mobile Share, more than 15% of subscribers have moved over from unlimited plans or about 1 million subscribers today.

During the quarter, we introduced larger Mobile Share plans targeting businesses as well as consumers who need more data. These plans offer up to 50 gigabytes per month and provide an attractive revenue yield. We also see the impact of the mobile Internet on our postpaid net adds, details are on slide 8. We have strong gains in tablets, this new growth area draw postpaid growth of almost 300,000 postpaid subscribers in the quarter. We also had another solid quarter with our connected devices adding 431,000 subscribers primarily with security and tracking devices.

Reseller and prepaid impacted our overall result or overall net adds. Reseller had a net loss this quarter primarily due to resellers rationalizing there are no or low usage accounts. These disconnect had a negative impact of more than 600,000 on reseller subscriber net ads in the quarter and on total subscriber net ads in the quarter. Although the reseller volumes involved were significant, it had little impact on revenue. In fact, our reseller revenue is up more than 50% year-over-year.

Prepaid sales continue to be impacted by declines in session-based tablets. We do see some changes across the mobile marketplace. As always, we continue to evaluate and look for opportunities to take advantage of our network, including new product offerings, funding opportunities and alternative forms of distribution, but we also continue to see improvements in churn.

Postpaid churn had another strong quarter, down year-over-year and sequentially. And we had our best ever first quarter smartphone churn, which was less than 1%. We did have a policy change with regard to third-party retailers that had a small impact on churn, but with or without that change, we saw a reduction in churn and we continue to see year-over-year improvements in postpaid churn.

Now, let's take a look at wireless margins on slide 9. Our wireless margin story continues a trend we've seen in recent quarters. Smartphone sales continue to be strong, but even with increased sales, margins are expanding. The story is no different this quarter. We set our first quarter record of 6 million smartphone sales, yet our wireless EBITDA service margin was 90 basis points higher when compared to the first quarter of 2012 or 43.2%.

Smartphone subscribers continue to be a wise investment. You know the long-term value they bring; higher ARPU, lower churn, strong data growth, driving growth in operating income, which was up more than 4% year-over-year.

We really feel good about our wireless position. Revenues continue to grow with expanding margins. The mobile Internet continues to bring strong data growth with more and more subscribers on usage-based data plans, customers continue to embrace our Mobile Share plans helping drive tablet growth and our LTE deployment is ahead of schedule and winning praise as the fastest in the industry. So, all in all, a really solid wireless performance has set the stage for a strong year in 2013 and beyond.

Now, let's look at our wireline operations, starting with consumer, which you can see on slide 10. Once again, we had another impressive U-verse performance with accelerating subscriber gains. The growth of our high speed IP broadband has been nothing short of dramatic. We added more IP broadband subscribers this quarter than ever before, more than 730,000, which helped drive our best total broadband net ads in two years. IP broadband now makes up more than half of our total broadband base with an ARPU growing at more than 9% year-over-year, plus we are gaining share against our competition.

U-verse TV also had a great quarter. We added 232,000 U-verse video customers, our best showing in nine quarters. These gains help drive overall consumer revenue growth of 2%. Adjusted for changes in regulatory fees it would have been nearly 2.5%, with U-verse revenues up more than 30% in the quarter often ever increasing base. So once again another solid quarter in consumer, and we see more opportunity for growth with our increasing U-verse penetration and planned Project VIP expansions.

Now, let's move to wireline business, which you can see on slide 11. When you look at the three major components of wireline business, you're seeing a similar story that we’ve talked about in prior quarters. The continued drop in small business starts is still pressuring that part of the revenue stream. Wholesale and government solutions continue to be challenged and our enterprise revenues after showing some positive signs last year were challenged in the first quarter. Combined business revenue was down sequentially and year-over-year, pressured somewhat by regulatory fees. Adjusting for those fees total business revenue was down 2.7%.

One bright spot was the strong growth in strategic business services. Those are products that are part of our Project Velocity investments including VPN, Ethernet, Hosting and other Advanced IP services. These were up 10.8% even in a very difficult economic environment. Expenses were down year-over-year to help offset some of the revenue decline, but uncertainty with the economy continues to be the issue.

Customers are delaying buying decisions, unemployment improvement continues to lag, the business overhang from regulatory uncertainty persists, and government budget issues are all having an impact on our customers and on our results, but the most challenging aspect for us is trying to forecast the future in this environment. Like others, we are looking for consistent signs of improvement. One thing that is not faltering in our confidence in the future is that it will be driven by high-bandwidth connectivity, mobility and the clouds. Nobody is positioned better to take advantage of these opportunities once the uncertainty passes and the economy turns.

Let me give you more detail on slide 12. AT&T is a recognized leader in solutions for hosting and cloud services. We offer network-centric integrated solutions that provide value to customers on a global basis. The foundation for our cloud services is having one of the worlds most powerful and advanced global MPLS networks that span 187 countries. We operate 38 datacenters that are fully integrated with that network, providing top-of-the-line security, reliability and management.

We see a future where our wireline network assets and mobility come together in the cloud that will mobilize workforces to access business information in a secure environment. AT&T’s expertise in this area has been recognized recently by industry analyst Gartner, who gave the company the highest rating for important capabilities for network services. We have the network, the right tools and the right products to win in the fast developing cloud market and we’re best positioned to take advantage of the growing opportunities in this space.

Now, let’s look at margins and cash flow, consolidated margin comparisons are on slide 13. For the first quarter consolidated margin was 18.9% down slightly from the year ago first quarter.

Wireless margin expansions offset wireline pressure. However expenses from corporate and new business initiatives did impact the overall margins. In wireline, pressure from business as well as success based expenses in consumer drove operating margins down slightly. Helping offset this pressure were growth in consumer revenues, operational improvements and solid execution of our one AT&T cost initiatives.

We continue to expect consolidated margins to be stable this year with growth in wireless offset by pressure in our investments in our wireline business.

Now let’s move to cash flow, which continues to be a very good story for us. A summary is on slide 14. In the first quarter, cash from operations totaled $8.2 billion. Capital expenditures were $4.3 billion with more than half of that invested in the wireless business, which gives us free cash flow before dividends of $3.9 billion more than $300 million improvement over last year’s first quarter.

Our CapEx expectations continue to be in the $21 billion range as we ramp Project VIP throughout this year. However, we are adjusting our longer-term capital spending expectations. We now expect capital spending to be in the $20 billion range for both 2014 and 2015 that is down from the $22 billion level we expected when we announced Project VIP last November. This reduction brings no slowdown in our Project VIP deployment.

As we have refined our VIP planning, we are seeing greater integration efficiencies in our spending curves. Our LTE build is accelerating into this year’s spending. That along with additional savings in non-Project VIP spending gives us confidence to revise our expectations without changing our overall build targets. Post Project VIP, we expect capital spending to take a step down to more normal levels.

Moving to dividends, payments for the quarter totaled $2.5 billion and we repurchased 168 million shares for $5.9 billion. This makes our total return to shareholders in the first quarter more than $8 billion and more than $30 billion in the last five quarters. Plus, as we announced last month, the AT&T Board approved an additional $300 million repurchase authorization. The Company expects to make huge repurchase decisions opportunistically, which will likely slow the pace of buybacks compared to recent activity.

In terms of uses of cash, total debt was up in the first quarter as we took advantage of historic low interest rates with a debt-to-capital ratio of about

46% and a net-debt-to-EBITDA ratio of 1.68, well within our guidance in the 1.8 range or lower.

We also continue working with the Department of Labor on a plan that would contribute a preferred interest in our AT&T Mobility to fund our pension plans. We continue to be optimistic on the strategy and expect approval of this proposal in 2013.

So all in all, another solid financial performance. Our balance sheet is sound, our debt metrics solid and our strong cash flow gives us the flexibility to invest in growth initiatives while returning value to shareholders.

Now, before we take questions let me close with a quick recap on slide 15. We are off to a good start to the year, and what gives us a lot of confidence looking ahead is that we built a strong, very strong foundation for growth for 2013 and beyond.

The spectrum position is solid. We are tracking ahead of schedule with our LTE deployment. Our 4G LTE network is the nation's fastest and winning quality awards across the country. Our capital spending is more effective and efficient than we originally expected. Insurance down and ARPU's are up and our smartphone and tablet gains continue to be very strong. The number of subscribers we have on usage-based plan is climbing fast. And on top of this, we have one of our best U-verse quarters ever and that's before our Project VIP wireline expansion really starts to ramp, which we expect to only make all of these things stronger as we move into the second half of 2013 and beyond.

So, we feel good about the foundation we've built. We feel good about the momentum we have. We are positioned to grow even in this slow economy. And we are well positioned to continue returning substantial value to shareholders.

With that, Susan, let's go ahead and take some questions.

Susan A. Johnson

Thank you, John. Tony, we will now open the call for our question-and-answer session.

Question-and-Answer Session

Operator

Thank you very much. (Operator Instructions) Your first question will come from Michael Rollins with Citi Investment Research. Please go ahead.

Michael I. Rollins – Citigroup Global Markets Inc.

Thanks and good afternoon. I was wondering if you could talk a little bit about the business revenue in more detail in terms of implied erosion of legacy services relative to strategic, is that being hurt by the cyclical as well as the secular, and is that something that continues at this rate, or do you see some improvement coming over the next 12 months to 24 months in that segment? Thanks.

John Stephens

So, good afternoon, Mike. Real quickly, if you breakdown the three segments, so to speak, of our business revenues into the small business side, we're encouraged by the acceptance of high speed broadband, U-verse type products, but the business is still challenged by lack of starts. We're seeing some positive improvement in our Wholesale business, but in our Government, Education And Medical, are still being really challenged by the economy and by funding, and Enterprise is continuing to be challenged by uncertainty and, if you will, delaying decisions even though they are spending on speed and advanced data services.

When we look at the overall business services, Mike, I think about it this way. It's hard to predict until we get some economic clarity, because while unemployment or regulatory concerns or government spending maybe affecting us as a individual company separately in different ways, it's definitely affecting our customers and still we get some clarity on that, it's hard to predict. But what we do feel good about it is the position we are in, when it turns, because we can provide that combination of integrated services like no other. Hopefully, that answered your question, Mike.

Michael I. Rollins – Citigroup Global Markets Inc.

Thanks, John.

Operator

Thank you. Our next question in queue will come from Simon Flannery with Morgan Stanley. Please go ahead.

Simon Flannery – Morgan Stanley & Co. LLC

Thank you very much. Good afternoon, John. You had a very good U-verse numbers, can you talk a lot about, what was driving that specifically? It doesn't sound like your footprint has expanded dramatically, that's going to be later on, was it promotional activity I see you've got a few new offers out there and do you think that this is sort of a new kind of turn in the corner as the DSO base becomes lower and then given your sort of leverages, is that moving up towards your 1.8, what's the latest thinking around potential for asset sales or other monetization? Thanks.

John Stephens

Thank you, Simon. And quite frankly on our U-verse positive developments both in small business and in consumer, I would tell you that the simple answer is really, really quality execution by our people and their teams. Certainly there were some promotions, certainly there were good opportunities that presented itself from existing assets, but I would tell you, that it focused on reducing churn, that it focused on shortening installation times, they focused on converting customers from legacy DSL services to the high speed U-verse services. It was really a whole collection of really quality execution by the team and I think that's what really drove it.

As you can see, we still drove revenue growth and we still are getting very good revenues on their triple-play on the consumer side, so it wasn't just incentive driven, it was really performance.

With regard to our balance sheet and our wherewithal, I guess the first item I point out here, Simon with regard your same question. As we've shown, we got a great balance sheet, very strong, strong cash flows, very great coverage of all of our responsibilities. So, we feel good about where we're at.

Clearly aware what's going on in the industry with regard to monetization strategies, we have a responsibility to look at all of those because we are here to monetize and maximize value for our shareholders, but with the strength of our balance sheet, we can be careful and prudent with regard to taking those steps and are not necessarily in a position, where we need to do any of that.

Simon Flannery – Morgan Stanley & Co. LLC

Thank you.

Operator

Thank you. Our next question in queue will come from the line of Phil Cusick with JPMorgan. Please go ahead

Phil A. Cusick – JPMorgan Securities LLC

Hi, guys thanks. I'm thinking about the revenue for guidance that you've talked about in wireless for mid single-digits long-term. And I'm struggling to figure out and sort of goes into subscriber and ARPU side as more of the subscribers come from tablets and assuming Digital Life launches fairly soon (inaudible) an update there. ARPU's slowing down hit 3.5% revenue growth in wireless this quarter. Can that be sustained given sort of where want the industries going and not growing by much, and two, coming to the other side of the smartphone growth or do we really need to prepare ourselves for us lower ARPU, lower revenue growth in wireless going forward, thanks

John Stephens

Thanks, Phil. First and foremost, we still feel good about our guidance about mid single-digits throughout the growth in the mobility business. I would suggest a couple of things, one; we do still have room to grow on the smartphone as we mentioned. Sales rates are 90%, current customer base is at 70%, that give us a lot of room to grow.

Secondly, we continue to see the adding of tablets and other DAM devices so that's going well. As we continue to complete our LTE deployment, we expect and we'll continue to see growth in other services like video and so forth. So that should provide us with future growth aptitude and all of that as before we roll out things like Digital Life, the connected card, Mobile Premise Solutions and a lot of the other opportunities that we have moving forward.

So we still feel good about where we are at, we are opportunistic and pleased about we're going think will forward with that. You specifically ask the question about Digital Lift, we're going to launch I think we've announced, we're going to launch 15 market in the, by the middle of the year in the spring of this year and so I think you will be hearing more about that soon.

Phil A. Cusick – JPMorgan Securities LLC

If I can just follow up for a quick second.

John Stephens

Sure.

Phil A. Cusick – JPMorgan Securities LLC

It seems like the wireless industry this quarter at least on a voice basis it's going to be very negative. And it looks you're negative on your own in terms of voice. Is there an acceptable situation for AT&T and can you continue to be set of negative on voice overtime as competitor set of loose your subscribers or do you need to tun it up a little bit and try and be positive there.

John Stephens

I guess, let me make one of the point that (inaudible), and I think people going to work our churn is done, and the fact that is continuously going down or really optimistic about growing revenues from that perspective, and as that happens we will see impacts on our total revenue base, but if you are asking, are we going to continue to see some form of conversion of revenue from voice to data that would surprise us, but we are positioned well with usage base plans to capture the revenue opportunity the Bad Data provides. So still feel good about all those opportunities, we just need to continue to execute and continue to move forward with our LTE, Bill.

Phil A. Cusick – JPMorgan Securities LLC

Thanks John.

Operator

Thank you. Our next question will come from John Hodulik with UBS. Please go ahead.

John C. Hodulik – UBS Securities LLC

Hey, thanks John a quick follow-up just on Bill question, really more focused on the ARPU, you saw some deceleration if you look at some of the components I think at least phone-only ARPU went from 2.5% growth last quarter to 2% this quarter, and then the dilution from these other high margin low ARPU devices almost doubled from 0.6% to 1.1%. I guess first what is driving the phone-only deceleration, is that just you still got a lot of penetration to go, but maybe the incremental penetration from a smartphone standpoint is slowing, and really if you put all these points together, should we continue to expect to see deceleration going forward or is it more of a alternative subs sort of story and less of an ARPU story, and then one of the thing I mean I don't know, you guys broke out home phone customers last quarter, I wondering if you guys are giving our that number, thanks.

John Stephens

John a couple of things, one ARPU is always impacted by quarterly fluctuations and level of sales and so forth, but quite frankly this quarter is impacted compared to prior quarters, but a change in the regulatory rates, there was 10% change in the regulatory fee rates that are charts are included our revenues, and so that I think it explains a fair amount of the differentiation in some of the revenue growth. That's all it is. So from that perspective when you take that into consideration, still feel real good about where ARPU is going and our phone-only ARPU.

John C. Hodulik – UBS Securities LLC

Okay. So the regulatory did hit that phone on the ARPU number?

John Stephens

Yes. I mean the…

John C. Hodulik – UBS Securities LLC

Okay. Got it.

John Stephens

U.S. ARPU rate is one down from 17.9% to 16.1%, about a 10% reduction.

John C. Hodulik – UBS Securities LLC

Got it.

John Stephens

So that's impacting all of our growth rate numbers and it's just part of the process.

Operator

Thank you. Our next question in queue will come from Mike McCormack with Nomura Securities. Please go ahead.

Mike McCormack – Nomura Securities International, Inc.

Hey, guys, thanks. John, can you just talk a little bit about, again on the wireline margin side. I know there is typically some first quarter seasonality to the others. Are there pieces that we should be thinking about the Project VIP impact, I guess I was expecting more of a sort of 2014 impact on success base. So I'm assuming that's been pulled forward, and can you just give a little more detail around that? And then lastly, any reaction to the upgrade policy chains on wireless at Verizon? Thanks.

John Stephens

So on wireline margins, it's specifically with regard to U-verse. A couple of points, Mike, I think you're heading on. One, our expansion of our footprint for U-verse services from Project Velocity is really a leader this year in 2014 type event. The sales and success in customers at both video and IP broadband was really great execution in this first quarter. It was an expanded selling space, but with that we still had success based cost and so we'll take those for these long-term valuable customers. So that's what I expect of it.

Two, I had expected as we expand the footprint and get additional coverage that we got out of Velocity, you will continue to see some really solid numbers and some pressure from the success of sales. I just believe the first quarter results there are real positive for going forward. So, I mean, you are right, we always have some first quarter pressure with regard to margins, that's not unusual, but it's in the comparison to last year also.

Mike McCormack – Nomura Securities International, Inc.

Is this the run rate we should be thinking about John as we progress through the next couple of quarters?

John Stephens

Yeah. I would suggest it this way. We still think we're going to come in slightly below. We all changed that guidance slightly below last year's margin amount, but we feel good about the efforts the team has gone through to manage the margins and if you think about the challenges we face in the business revenues, were really performing well on cost management.

Mike, on your question with regard to some of the changes going into the marketplace, absolutely the marketplace is dynamic and it's changing and we're looking at those changes and evaluating them and trying to stay current with all aspects of it. I don't have anything to announce today, but we're respectful of our competitors in this environment, but we're also pretty comfortable with the fact that we're going to be able to continue to compete at a very high level.

Mike McCormack – Nomura Securities International, Inc.

Great, thanks John.

Operator

Thank you. Our next question will come from Jason Armstrong with Goldman Sachs. Please go ahead.

Jason Armstrong – Goldman Sachs

Hi, great. Thank you. John, maybe a couple of questions, first on, tablets, you obviously had a really good quarter. You had a partial subsidy model attached to that and I am wondering and thinking through that is the subsidy maybe something you used just to stimulate demand temporarily and to replace these devices in the base or is that more of a sort of recurring part of the model if you go forward.

And then second question just on leverage, the 1.8 turn, I think my understanding was to create room to invest in Project VIP and to go through a big capital cycle over the course of 3 years and still leave room to buy back shares aggressively if you wanted to. With reducing the capital spending targets here but still leaving the leverage target out there, sort of the same ratio does that signal an intention to continue to tap that capacity for additional share buybacks? I know you said buybacks were slowing from here but it seems like you still have plenty of room, is that the case? Thanks.

John Stephens

Okay, great Jason. Let me cover you second question first. With regard to the 1.8, it was a couple of things, yes it was a recognition of the fact that we're going to add some higher capital spend. And 2, it was also a recognition of historically low interest rates. If you look at our interest expense first quarter '12, first quarter '13 you will see that even though our debt levels have increased, our overall interest expense is down and that's really what we were trying to take advantage of. It's the fact that there is a lot of really inexpensive or attractively priced debt capital and with company like ours who has a very solid dividend, we are finding prudent in making the decisions about which capital to utilize.

With that being said, yes the reduction in the project VIP capital projection of the last two years will provide us additional flexibility and that is important to us. With that being said we're going to stick with what we guided in the presentation and that is we're going to be opportunistic with the additional buy back. We'd expect to finish this $600 million share authorization in the second quarter and we will be opportunistic and potentially buy at a slower pace as we go forward.

The other question, I think you had, Jason, was on tablet and I would suggest you that you've identified it right. We put that in place to see how it would work to stimulate demand and see what kind of, not only take rates we get on the tablet, but also what kind of ARPU's we would get. After our initial testing of that in the fourth quarter we decided to stay with it because we have found that the economics make a lot of sense.

I won't suggest to you that it's a permanent offering, but I'll suggest to you it will continue to moderate and make a decision as we go forward with regard to keeping in place or adjusting it, just like we do with all our product offerings.

Jason Armstrong – Goldman Sachs

Thanks, John.

Operator

Thank you. Our next question in the queue will come from the line of Colby Synesael with Cowen & Company. Please go ahead.

Colby A. Synesael – Cowen & Co. LLC

Great. I've two questions. First, on the regulatory fees both in wireless and wireline, curious if those all began on January 1 or if that happened mid-quarter and therefore there is more of an impact to be seen in the second quarter, and also how that relates back to your previous guidance of 2% or greater than 2% consolidated revenue growth? And then, my second question has to do with M&A and what's the company's appetite for M&A particularly outside the U.S. and even more so in Europe. Has that increased or decreased perhaps over the last, I guess, since the beginning of the year? Thanks.

John Stephens

So, welcome Colby. The first thing I want to mention to you is that right now we are not changing our guidance with regard to greater than 2% of revenue growth for the year or certainly sensitive in a situation at hand with regard to the economy and the impact it's having on business revenues. So we want to be respectful of that and we understand those aspects. So the challenges of the economy and the challenges arise from business is something we follow very closely.

With regard to the regulatory fees, those rates are in place for the quarter. That differential was for the first quarter. The new rates have been established for the second quarter and I believe the differential year-over-year is about the same in different rates, but it's about the same step down. So somehow that regulatory fee pressure will continue throughout the second quarter. We're aware of that and so we're taking that into account in all of our planning.

With regard to M&A activity, we don't comment on any M&A activity and I'm not going to do that now. Yes, we've said before. The real issues we find is that the U.S. marketplace that we operate in is well ahead of, appears to be well ahead of the rest of the world and mobility and the developments [around] mobility and as stewards of our shareholders' assets, we need to see if we can provide and take advantage of the assets and knowledge we have and provide value for our shareholders based on what we've learned. But we don't comment on M&A activities and I won't comment any now.

Colby A. Synesael – Cowen & Co. LLC

Okay. Thank you.

Operator

Thank you. Our next question in queue will come from David Barden with Bank of America. Please go ahead.

David W. Barden – Bank of America Merrill Lynch

Hey, guys. Thanks for taking my questions. John, it looks like with the tax benefit in the income statement and the deferred tax gain in the cash flow statement, it looks like you guys got about $1 billion tax contribution positive to the quarter. Could you talk a little bit about how you see that shaping up over the course of the year contributing to the $14 billion free cash flow or better guidance, and then obviously how the contribution of the wireless business is going to layer in over the course of the year on that front?

And then, a second question, if I could just kind of go back to this. I just want to be kind of make sure I understand what's that. I think what you were saying is that from a competitive standpoint, from a wireless subscriber of growth standpoint, AT&T is satisfied with how you did this quarter, say the course in terms of general approach to the market irrespective of what's going on T-Mobile. And then, as the LTE business kind of ramps up look to that for future revenue growth opportunities. Is that a fair assessment of what you said earlier? Thanks.

John Stephens

Thanks, Dave. Let me take one at a time. First of all, on the tax side of the earnings, we recognize the fact there was around a $0.03 benefit in the income tax line, a reduction of expense and that's what we've adjusted in our presentation. If you pull that out that leaves us with an effective tax rate just under 33% and I think those of you who probably know that are kind of normal effective tax rate to somewhere in that 33% to 34% range, they wouldn't expect that to be any different for the rest of the year.

Secondly, with regard to taxes and cash flow, first of all, we take into account and as with our cash tax payments as we determine cash flow and as part of our cash from operations. So that's all included and we continue to guide that pre-cash flow will be in excess of $14 billion this year. I understand people questioning that number based on the fact that we are $3.9 billion in the first quarter and that's higher than last year, understand the question, but right now we will continue to guide to greater than $14 billion.

With regard to mobility business, make sure I clarify the sense of we follow the marketplace. We continue to look at what others are doing and what we are doing ourselves and we continue to develop ideas and methodologies and processes to be more competitive. The best example I can give you is the Mobile Share plans as well as Digital Life. So we're doing that all the time. We will continue to do that, don't have any new ideas or new product offerings or bundles to announce to you today, but I don't want to suggest to you that, there is a lack of activity on improving our business or growing it more rapidly than it's growing today.

David W. Barden – Bank of America Merrill Lynch

All right. And John, just a follow-up quick on how the contribution of the wireless stake is going to get flow through the tax fine and casual benefit for rest of the year?

John Stephens

Yeah. We have taken into account any of the tax benefits at cash or expense benefits into account in our planning, in the guidance we gave in January and quite frankly the cash flow guidance which I just refreshed and EPS guidance which is what I was changing has already taking that into account.

David W. Barden – Bank of America Merrill Lynch

Got it. Thanks guys.

Operator

Thank you. Our next question in queue will come from the line of Tim Horan with Oppenheimer. Please go ahead.

Timothy Horan – Oppenheimer

Well, thanks guys. Just two broad questions; back on the wireless front, John maybe to go into little bit more, do you think you have pricing power in wireless as it improve versus where you were couple of years ago and do you think you can take advantage of that?

And then secondly, maybe you can built into on the supplier side a little bit more, it sounds like the CapEx obviously it's coming below expectations for the next couple of years, which is great, but is that something that's coming from just better pricing that you are seeing on the supplier front?

And I guess back to question I have on second quarter, can we start to see the same thing on the handset side? Do you think you have a little bit more leverage at this stage on the hands of supplier front. Thanks.

John Stephens

So, good to hear from you, so let me pick a few things. One thing, I would tell you this on the wireless side, the way I think about it is this improving network that we have and the recognition from RootMetrics now, the fastest, but the highest quality and this more rapid deployment than we expected that I expect with regard to our LTE really gives us feeling good about the opportunities for the overall wireless business to add more customers through lower return, retain more customers and to generate revenue from usage-based devices. So I think, if you will, the powerful piece of our wireless business that's going on now is really this opportunity to utilize that really powerful LTE network and grow the business. That's how,

With regard to CapEx, I would suggest you that there is couple of things going on. One, we got deployment out of the LTE faster on an accelerated basis even last year when we guided to finish at 150 million LTE POPs and we have the earnings now. So we're at about 170 million and now we're guiding to be nearly 90% complete with our 300 million POP by the end of this year. So that acceleration is taking some of the CapEx pressure off of 2014 and 2015.

Secondly, we are finding that the integration opportunities when we do, if you will, a bottoms up build plan analysis or finding more integration efficiencies and opportunities than we had originally planned for and that's driving a lot of the savings. And third, the ability to get out there quicker is really taking off some of the pressure that we expected there with some of our core non-velocity investments. So those are all combining. We're getting efficiency and the build and effectiveness of build and pushing it that way. I would suggest that's where the capital savings are coming from.

The last thing Tim, I would suggest you as we are always looking at ways to improve the economics of the handset model. We think that's certainly really important and we continue to look for ways to do that, but I will tell you we continue to do with the focus on the customer and making sure we developed ideas that are not only focused on economic efficiency for us but for customer satisfaction. We believe we have to have both piece of that to really be successful long-term within.

Timothy Horan – Oppenheimer

Thank you.

Operator

Thank you. Our next question in queue will come from Chris Larsen with Piper Jaffray. Please go ahead. And Chris Larsen your line is open please go ahead with your question.

Chris M. Larsen – Piper Jaffray, Inc.

Yeah, I wonder if we could switch over to slide 12 where you talked about the cloud and hosting there. And two questions specifically, first, if you could talk a little bit about what you have been seeing in terms of pricing on cloud. There has been a lot made, the recent pricing declines out of the Amazon and Rackspace and how that has affected you? And then given the fact that you dedicated a slide or two in your slide deck, maybe you can size up that opportunity, how big does that have to come before, can begin to move the needle here on the top line for wireline results? Thanks.

John Stephens

So a couple of things. One, we forgot to how move the needle on wireline results, as you all know our wireline revenue base is in that $60 billion plus range. So I'll leave it your own judgment on how big it need to get, if you will move that needle. But we believe it's a real opportunity for us to help us growing that revenue and also providing us the opportunity to continue to provide those network base services. So, keeping the traffic on our services as well as providing the security and the other hosting services.

So, we believe that the opportunity is strong for us. I would suggest you even recent events will tell you that with regard to our managed network in our security opportunities will provide an even better advantage for us that's one.

With regard to recent pricing activities, I would suggest you that I think there is going to be continued pricing movement in this area, we're aware of that, we're prepared for that. But we feel long-term we can provide a quality product with good margins to generate returns for our shareholders. So we think it's very much worth our investment. And specifically we believe it because, we have the, if you will dual side of not only providing the cloud and the hosting. But also being able to provide the mobility connectivity to that for a customer's employee base. So we feel really good about both sides of it.

Chris M. Larsen – Piper Jaffray, Inc.

Thank you.

Susan Johnson

I think we've got time for just one more question.

Operator

Thank you very much. And then final question will come from Brett Feldman with Deutsche Bank. Please go ahead.

Brett J. Feldman – Deutsche Bank Securities, Inc.

Thanks for getting me in. So some of the earlier questions we're sort of eluding to the fact that your postpaid phone base slipped a little bit in the quarter. And obviously the first quarter is seasonally slow and so it's hard to read into that. But if you put seasonality aside, what do you anticipate for your traditional phone base going forward? Is it something that we should see outside of a seasonally slow period continuing to grow or are you somewhat indifferent now not because you don't care, but just because the real revenue growth driver going forward is data volume on your network and not necessarily the net changing your phone base quarter-to-quarter.

John Stephens

Yeah, so I think we do find important to continue do if you will grow our phone base, but more importantly convert our phone base because if you think about that the differential between 70% of our postpaid and the 90% sales flow. If you think about that on our base it's 14 million customers and when you convert them to smartphones you may think of them as a phone but there are generating significant data usage on the network and an opportunity for real revenue creation, so we are focused on, but we are also focused on growing our customer base. I don't want to leave you with the impression of just conversion, it's both and we believe we are positioned well to do that. So I think it's both aspects of that, but when we got the quality network like we do and great sales operations like we have and a customer focused approach, we are optimistic about our ability to be very successful.

Brett J. Feldman – Deutsche Bank Securities, Inc.

Thanks for taking the question.

John Stephens

I want to thank you for being with us this afternoon. We have had a solid start to the year and believe we have built a very strong foundation for growth going forward. Our momentum is solid, our balance sheet is strong and our Project VIP expansion is going to bring us even more opportunity. As always, we thank you for being on the call and we thank you for your interest in AT&T. Good night.