Operator

Ladies and gentlemen, thank you for standing by and welcome to the AT&T Fourth Quarter Earnings 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]

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

Michael Viola

Thank you, Tony. Good afternoon everybody. Welcome to our fourth quarter conference call. It's great to have all of you with us. Joining me on the call today is Randall Stephenson, AT&T's Chairman and Chief Executive Officer, and John Stephens, AT&T's Chief Financial Officer.

Randall will provide some opening comments and then he'll close with 2016 guidance. John will cover our results and we'll follow all of that up with a Q&A session. Let me remind you, our earnings material is available on the Investor Relations page of the AT&T Web-site. That's att.com/investor.relations.

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

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

Randall L. Stephenson

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

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

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

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

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

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

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

The common thread to all of this is providing our customers with a seamless integrated experience, and again the core to making all of this happen is the network, and our LTE network now covers 355 million people and businesses in North America, and we expect to hit the 385 million mark by the end of this year. We're continuing to build out our GigaPower footprint, and we can now deliver speeds up to 1 gig to over 1 million customer locations in 20 markets, and we've announced plans to enter an additional 36 markets. We also continue to expand our fiber network to more businesses, so we're really feeling good about our networks, and we believe we do have the most comprehensive capabilities now in the industry.

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

And also in 2015, we built on our global leadership position in the Internet of Things and our IoT solutions are not U.S. solutions, they are global solutions. We invested very early in this space and it is paying off. We now have over 26 million devices connected to our network. We're also a leader in Connected Cars. We added a million of them in the fourth quarter and recently we completed a deal with Ford that we believe is going to connect at least 10 million cars over the next five years.

And finally, we're investing aggressively in the network architecture that is going to give us a competitive advantage in cost. We're driving the industry to software defined networks, and I have seen few opportunities over my career to drive down the cost to deliver service like this. We're also on track to deliver at least $2.5 billion in annual DIRECTV synergies by 2018, and we continue to invest in spectrum. We began last year by investing $18 billion in the auction to significantly deepen our spectrum footprint, and as a result we now have 40 MHz of fallow spectrum to deploy over the next few years to support TV Everywhere.

But just as important is the impact that such a deep spectrum footprint will have on our cost to build and operate our networks. So as we look out over the next few years, we're convinced the software and defined networks combined with the DIRECTV synergies and our deep spectrum position are going to give us an industry-leading cost structure, and our objective is really straight-forward, we want to move the most traffic at the lowest cost per bit.

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

If you look at Slide 5, as you see, adjusted EPS growth was solid, our cash flows were way up, margins continued to expand, and consolidated revenue growth was on track. We ended 2015 with 137 million mobility subscribers, 45 million video subscribers, 13 million IP broadband customers, and an LTE network that's covering 355 million people, and we're seeing nice growth across all of our key product categories. In the fourth quarter, we had really solid net adds at wireless, satellite, video, and IP broadband.

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

John J. Stephens

Thanks, Randall, and hello everyone. It's great to have you on the call. Let's start by taking a look at the quarter and our financial summary on Slide 6. We finished the year strong. We had double-digit growth in consolidated revenues, adjusted earnings, and free cash flow. At the same time, we continued to see margin expansion in every segment of our domestic business.

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

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

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

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

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

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

We served the total connectivity needs of our customers and more and more that means mobility. Mobility and cloud solutions are changing the way business gets done and AT&T is delivering this to customers. We're connecting people, cars, homes, cities, devices, machines and businesses to the Internet and each other. We've established ourselves as the world leader in IoT. We signed more than 300 new Internet of Things business agreements in 2015 alone. Our recently announced new Connected Car agreements with Ford and BMW build on our industry leadership in that category and our new Smart Cities and Connected Health initiatives demonstrate how connected devices can help cut costs, grow revenues, boost efficiency and satisfy customers' needs.

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

We also saw exceptional margin expansion which points directly to the benefits of the acquisition. Our EBITDA margins came in at more than 22%. That's up more than 800 basis points year-over-year. We shifted our marketing focus to driving satellite net adds and you can see that in our subscriber results. Satellite net adds were 214,000 with our total video net adds for the quarter down just slightly.

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

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

These offers definitely add some sizzle to our bundling offers but the real impact is to build a strong relationship with our customer base. Our goal is that TV Everywhere experience with broad viewer choice both inside and outside of home that is simple and easy for our customers to use. AT&T is already a leading provider of online video.

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

Now let's move to our U.S. Mobility results on Slide 9. As a reminder, AT&T's domestic mobility operations are now divided between the Business Solutions and Consumer Wireless segments. For comparison purposes, we're providing supplemental information for our total U.S. wireless operations here.

During the fourth quarter, total net adds came in strong with 2.2 million new subscribers and with gains in every customer category. That's the third consecutive quarter where net adds have exceeded 2 million. Almost 1 million of those net adds were branded which includes both postpaid and prepaid, driving positive phone additions in the quarter. We're putting a lot more focus on branded customers and with good reason.

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

We also continued to grow our high-value smartphone base, adding about 1 million branded smartphone subs during the quarter. At the same time, we had another strong churn quarter. Total churn was down year-over-year once again, thanks to our great networks, our quality offers and our top-notch customer service. Postpaid churn came in at 1.18% for the quarter, an improvement from the year ago quarter, and full-year postpaid churn was 1.09%, one of our best years ever. That's an impressive performance at a time when we focus on higher value subscribers in a heavily competitive market.

And I need to add a point about the Cricket churn. We have seen improving churns throughout the year even as we shut down the legacy CDMA network and move subscribers to our 4G LTE network. Fourth quarter Cricket churn was the best yet, coming in at 3.8% or 170 point improvement over last year's fourth quarter and about half when you look at the comparable weak fourth quarter from two years ago. Cricket has become a powerful part of our wireless story and we are very pleased at how it's performing and we expect it to do even more in 2016.

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

We also had our best ever full year service EBITDA margin coming in at 46.7%. By the way, if you exclude regulatory and insurance fees from service revenues, as some of our competitors do, our full-year number is about 50%. Total wireless revenue was impacted by lower smartphone sales. Service revenues continue to stabilize. Equipment revenues also were impacted by increasing number of bring-your-own-device subscribers. We had about 700,000 in the quarter. That includes those who purchased new smartphones through vendor leasing programs or vendor installment programs. BYOD sales are our lowest cost subscribers and we're happy to have them. They value our quality network coverage and reliability as well as our [indiscernible] selection of rate plans.

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

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

We also launched our rebranding to the AT&T name in several areas, beginning in markets where we've deployed LTE. That includes Guadalajara and Monterrey with Mexico City slated for April. And we continue to expand our distribution network. We've added 1,000 new store locations since we acquired these properties earlier in the year. All of this helped drive strong subscriber growth for the quarter with nearly 600,000 total net adds with gains in both prepaid and postpaid.

Mexico financials continue to reflect our operational investment and strong subscriber growth. We expect comparable results for the first half of the year and the investment cycle to continue through 2016. In Latin America, our DIRECTV operations continue to show solid growth on a local currency basis, but foreign exchange rates continue to pressure our results. Revenues, ARPUs and margins are all pressured by FX, are being hampered by challenging economies across Latin America. Subscriber pressures in Brazil impacted net adds. But even with all of this, we generated modest positive cash flow from these operations in the quarter.

All in all, we feel very confident that we will be able to create value with this business and with these assets. We're more integrated with the day-to-day operations and we have solid local management teams that are adding stability in a very challenging economic environment.

Now let's move to the consolidated margins on Slide 12. Consolidated margins reflect the overall strength of our business. Adjusted consolidated income margin came in at 16.8% in the quarter. This was a 230 basis point improvement over the year ago fourth quarter. And adjusted EBITDA margin was 160 basis points higher than a year ago. Strong fourth quarter results helped drive 130 basis point improvement in the full-year adjusted operating income margin. That's a tremendous accomplishment for a company with $146 billion in revenue.

There were some reasons for this improvement. Strong margin expansion in our Entertainment Group and Business Solutions and our focused sales approach and efficiencies in wireless drove strong consumer mobility margin gains as well. We'll continue our laser focus on cost reductions. We've driven savings through greater efficiencies, productivity gains and expense savings. Project Agile continues to build momentum as do our Digital First initiatives. We're seeing cycle time reduction and lower call volumes.

Software defined networking will radically reshape not only our cost but also the flexibility of our network deployment. Our margin momentum continues to be strong. We're confident we'll continue to expand [indiscernible] margins and to cut costs to offset pressure while we're in the investment cycle in Mexico.

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

Capital investment totaled $6.8 billion for the quarter. This includes about $700 million that we spent in Mexico where we received equipment and are putting it into service in the normal course, but we've got financing terms from our vendors that don't require us to pay for it until the end of 2016 or a little bit later. For the year, we made capital investments of nearly $21 billion.

Free cash flow was $3.1 billion. For the full year, it was nearly $16 billion, coming in higher than our increased guidance. We also continued to tap the securitization market to manage working capital with Next. We received about 900 million in the fourth quarter. When you combine this with the foregone payments from prior securitizations, the net impact is about $100 million of pressure on cash flow. So cash flow in and of itself was very strong from operations.

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

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

Randall L. Stephenson

Okay. Thank you, John. Last summer we provided a long-term guidance after we closed the DIRECTV deal and it really hasn't changed. We're tracking almost exactly on what we told you. And so when you look at 2016, what you can expect is double-digit consolidated revenue growth, adjusted EPS growth in the mid-single digit range or better, stable consolidated margins with a solid business plan to improve in each segment even while we're investing in Mexico. Capital spending will be in the $22 billion range with our focus on cost efficiencies and SDN creating a downward bias to that forecast, and we expect our free cash flow dividend payout ratio to be in the 70s with a goal of growing free cash flow this year.

So that kind of wraps it up and with that John and Mike and I are glad to stay in for questions. So, Tony, we'll turn it back to you.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question will come from Mike McCormack with Jefferies. Please go ahead.

Michael McCormack

John, maybe just a comment on the service revenue in overall wireless should be sort of lapping the big mobile share value push last year. Just trying to get a sense for the trajectory on the year-over-year decline. It looks like it continues to get better. I'm assuming we should expect that throughout the year. And then secondly on the Entertainment segment, I guess looking at sequential margins versus year-over-year, it looks flatter sequentially but there was the impact of the revenue recognition change. Just trying to get a sense for what we should be thinking about with margin trajectory there, maybe particularly as you go in there and get more wireless rights for content and maybe where those wireless right content costs flow through the model?

John J. Stephens

Let me give you a couple of insights there. First into the service revenues in wireless, we have to wait and see what 2016 brings, but we're expecting it to improve throughout the year, the year-over-year trends. We continue to see a little optimism in what we're seeing from the customers and demand, so we expect to see improvement throughout the year in that service revenue.

On the Entertainment margins, the first point I'd like to make is the $300 millionrevenue deferral did impact margins in this quarter. The margins would have been close to a couple of basis points higher if we would have had that recognition. That's the first point I want to make to you.

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

Michael McCormack

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

John J. Stephens

We expect it to flow through in the Entertainment Group.

Operator

That will come from Phil Cusick with J.P. Morgan. Please go ahead.

Philip Cusick

Two things. First to follow-up on Mike's question, can you just remind us, John, what the deferral is and will that impact revenue any further or is this sort of the most you'll need to defer? And then second, Randall, since 2009 you've been known as a bit of an economic savant. Can you give us an idea of what you're seeing from your customers in the U.S., both consumer and enterprise, and do you see any signs of economic weakness?

John J. Stephens

Phil, on the revenue deferral, this had to do with one of our major contracts and a customer signed up a two-year contract, and so previously DTV had recognized equally over each month of the contract. We recognize it as we bill it. So we just came to a consistency, brought it to the AT&T methodology. So that $300 million is not in anyway, shape, or form lost revenue, it's just deferred, doesn't change our customer contracts, it won't change our cash collection. It's just a deferral. And additionally, we didn't defer any expenses. We continue to recognize any out of pocket expenses with regard to that in the same way we have done before.

Philip Cusick

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

John J. Stephens

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

Philip Cusick

Got it.

Randall L. Stephenson

Phil, this is Randall. 'You're economic savant', I've never been called that. So it won't surprise you what we are seeing. We are seeing some softness if you look at enterprise business on anybody that has anything that touches oil and gas industry. All those companies are a little bit defensive right now as you might guess. Also anybody, big exporters, people who are exporting, who have exposure to foreign currencies, particularly the strong dollar, we're seeing weakness there. But I will tell you, we are kind of netted out. Our revenues kind of held their own on the business side because we are taking share and NetBond and Network on Demand, we're having a lot of success in the marketplace, and so we're taking share and holding our own but we are seeing some softness in those areas.

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

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

What I am concerned about, I'll be honest with you, is as you look at 2015, there are a lot of things that went the consumers' way and that went the economy's way, not the least of which are energy prices. But even over the last few years, there's been some benefit from 2 million people being put back to work. And so as we get to end of 2015, those benefits that we've seen over the last couple of quarters, if you look forward, are you going to see those in the future, probably not. And so I made a comment last week that got picked up that we're assuming 2%, if you ask me to kind of handicap is there more downside or upside to that, probably downside, but it's probably within a tight range of 2% is what our estimate is right now.

Operator

Our next question in queue will come from Amir Rozwadowski with Barclays. Please go ahead.

Amir Rozwadowski

The first question I wanted to ask was around your strategy in the mobile area. As you mentioned, Randall, during the prepared remarks, you have unveiled what I assume is the first of many plans integrating your mobile and video anywhere solutions. How should we think about your approach towards the competitive landscape going forward in terms of your go to market strategy? I mean it does seems though on a relative basis you probably weren't as promotional as some of your competitors, and would love to hear your thoughts as we progress through 2016.

Randall L. Stephenson

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

What you should expect is you're just going to continue to see as we roll through 2016 capabilities and offers that take advantage of putting the two together, and the customer experience is going to continue to get better and you're going to see offers that we think are unique in the marketplace. I'm not going to get very detailed with you right now, Amir, because we are still in the process of getting some of the really critical content deals secured, but things are coming together very nicely and you're going to see this kind of a phased rollout over the next few days and in fact over the next 45 days you will get your first look what one of these will look like, and so stay tuned.

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

Amir Rozwadowski

Thank you very much. And then maybe if I can switch gears to the video side, as you mentioned it seems though you continue to benefit from [indiscernible] integration has progressed, are you on the verge of rolling out more converged offerings with broadband and video and how should we think about that opportunity set for yourselves?

Randall L. Stephenson

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

Also keep in mind that we don't even have the installation workforce up to speed on provisioning this. So we're just getting the installation and workforce up. We just had the latest union contract gave us the rights we needed to push this out across our entire footprint. And so you're going to see us continue to get better and better there as well.

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

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

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

Operator

The next question in queue will come from Brett Feldman with Goldman Sachs. Please go ahead.

Brett Feldman

John, just a question on the cash flow outlook that you provided for this year, you obviously gave us some help thinking about the revenue, the EBITDA and the CapEx piece parts in that calculation. I think you mentioned some deferred CapEx related to Mexico. I'm curious if that's factored into the guidance. If you can give us any help on how to think about cash taxes with deferred bonus depreciation or extended bonus depreciation and anything else that we need to think about, like pension, that would be very value added. Thanks so much.

John J. Stephens

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

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

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

With regard to that pressure on cash flow, it did not come from our pension. We have a pension contribution we'll make this year and about $200 million but that's already been in the plans. That's the only thing that's required. Our pension plan is very well funded.

And then we do expect total tax payments to be up this year on a year-over-year basis, but as you know from our prior year filings, our tax payments were really modest last year, and so we would expect those to go out. But all in, we feel pretty comfortable hitting our guidance and we are certainly working very, very hard to do better on that guidance.

Brett Feldman

And just to make sure I heard it correctly, and maybe I didn't, but I think you said that this year's CapEx did include some of the deferred payments in Mexico, meaning that you will hit your free cash flow next year even though you have already recognized the CapEx early on your [indiscernible]?

John J. Stephens

So [indiscernible] talk about CapEx is like it was this year that it was 20.7 and we'll have about that 15% of service revenues which is about, so it gets to be about $22 billion for this year. That will be our CapEx. The working capital impact of paying for some of last year's purchases this year is in our working capital calculations. I think of it separately from my CapEx numbers, but yes, it's already in that guidance, so we will be adjusting the guidance for that.

Operator

The next question will come from David Barden with Bank of America Merrill Lynch. Please go ahead.

David Barden

Maybe this one is for John or Randall, for the first time in a while we're looking at some reasonably comfortable headroom on the balance sheet, 2.3x leverage versus I think your kind of historical comfort level limit of 2.5 turns, and for a company of AT&T size that's a real money. Obviously we have the 600 MHz auction coming up. New York Post tells us you are buying Time Warner. It is obviously a lot of things that could be on the agenda here including just sticking to your deleveraging agenda. Could you kind of rank order some of the ways you want to use what headroom appears to be there relative to the deleveraging priorities?

John J. Stephens

With our strong cash flows, we're going to continue invest in networks as we've said, keep this quality up and keep these product offerings moving out and we feel comfortable about doing that within that $22 billion range, but we do believe that positions us well. We do think that includes all our merger and integration activities. We've got a lot of fallow spectrum out there that we bought over the last few years. So we're in a very good position to be able to operate within those kinds of parameters and still provide the highest quality service.

With regard to the cash after we've done that investment [indiscernible] and we're going to continue to be [indiscernible] loyal and respectful of our shareholders in accordance with our Board's direction. Third, we're going to focus on reducing debt levels. But with that, as you do that, you keep your balance, be strong and keep opportunities available, but that's where we'll be focusing.

Randall L. Stephenson

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

David Barden

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

Randall L. Stephenson

We'll see what the auction brings and then how everybody participates, but I haven't been bashful in saying if there's an opportunity to get another 2x10 at that spectrum, we would pursue it. And so we think we can do that within the guidance John has given here and execute on that, but we'll have to see, David. It's not yet to us really clear what the spectrum footprints are going to look like and whether you can piece together truly a ubiquitous 2x10 type footprint which is really important to us to be bringing another band of spectrum into our operation, it's going to be really important to have a ubiquitous broad footprint. And so we'll have to look at that and obviously we're going to have to look at the person, that bid that the government has just issued the RFP on. So there are a lot of ways we'll evaluate the spectrum scenario, but it's reasonable to assume that we'll be active one place or the other.

Operator

Our next question in queue will come from James Ratcliffe with Buckingham Research Group. Please go ahead.

James Ratcliffe

Two if I could. First of all, just to dive in a little more into the DTV integration, any incremental thoughts on sizing what the revenue upside there is? I know it's early but now that you have for example some track record regarding unlimited data and you'd be able to share data across the two operations. And secondly, any incremental thoughts and the status of sponsored data and how you expect to see that roll out over the course of the year?

John J. Stephens

On the DTV integration and the revenue upside, let me frame it this way. We are pleased with what we have seen so far, specifically the unlimited data and the wireless I mentioned here. We had 500,000 wireless customers signed up for it already. So we're overall pleased with it. We think there's [great opportunity] [ph] there. The timing of those could give us a reason for some carefulness there for this reason.

For example, Randall mentioned the training of our technicians who do the installs. We're just going through the completion of that now, and that's really going to be more off a second half of the year where we'll see how really effective that is. We have seen a lot more bundling of the satellite with broadband but we need some more time to make sure that we understand the momentum of that and the progress of that.

Additionally, we are still going through the sales process of training our reps who never sold broadband when they sold satellite before or who sold broadband but never sold satellite before, and as Randall pointed out, because we sell wireless we have to increase all their sales activities, whether in the stores or in the call centers.

So all of this is going to take some time for us to really track [indiscernible]. I will tell you, we are optimistic and pleased with the initial results but giving any guidance on the revenue synergy sort of perspective is a little premature.

Randall L. Stephenson

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

Now if you think about the most premium set of content, whether it would be sports programming, whether it would be binged type programming that has stacking rights and [look-back] [ph] capabilities, whether it would be movie libraries or whatnot, it's just a very, very robust set of content that we're piecing together here to be delivered. I think one would just have to assume that sponsored data would be a critical element on how the customer would take advantage of this.

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

Operator

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

Simon Flannery

Perhaps you could give us some sense of what you are including in 2016 guidance for realized synergies and any kind of expectation around what integration cost might be this year? And then Randall, following up on that content theme, maybe you can update us on the Otter Media and the joint venture with Chernin and any perspective on whether you want to get deeper into ownership of content more broadly?

Randall L. Stephenson

Simon, let's say it this way, by the end of the year we expect to be on a run rate of $1.5 billion, which is going to be about $125 million a month. That's how we think about it. That's how we're doing our plans. I certainly don't mean to imply we're at that level in January, don't want to convey that, we're not, I don't expect that, but we expect it to grow throughout the year. We did have a very good first five months of getting costs aligned and addressing a lot of the administrative or headquarter some of the easier costs to start getting out.

So we did well with that and we're making good progress on the content, and quite frankly are shifting to a satellite based customer base is helping. But from your question perspective, I would think of it in that way that we are going to hit and hopefully exceed the $1.5 billion run rate which will be $125 million a month by the kind of December timeframe, fourth quarter timeframe.

With regard to any capital required for those integration costs, that's already included in the $22 billion of capital guidance. And from the expectation of integration costs, while we have some, without giving guidance, I would suggest to you this way, if you think about what makes up our integration savings or merger savings, content negotiation, staffing, supply chain, the cost to do that are not necessarily significant. It's just a matter of getting it done and doing the business. So I wouldn't expect those types of merger integration costs to be significant.

I will tell you we're still going to have customer facing amortization, trademark, trade names amortization, those kinds of normal merger integration. We're pretty explicit with those in the details we provide in our filings.

On the content side, and specifically you asked about [RV] [ph], that's going well. We're still early, but as everybody knows, we're partnered with Peter Chernin who I think probably is the best content talent on the planet, and early leveraging the Fullscreen acquisition that we did out of Otter Media, Fullscreen is obviously moving into a subscription model. We're really early to see how that progresses. But we're using that platform to do a lot of work for developing what I will call mobile centric content designed for the mobile device, and very optimistic about what the opportunities are there.

In terms of other or broader content ownership, there are a number of areas where we have what I'll call proprietary content. We own a number of regional sports networks. Some of those we acquired through the DIRECTV acquisition. Others we have acquired over the course of the last year. We also have a lot of what I will call exclusive content that is produced by us, everything from the Dan Patrick Show to a particular network we have on DIRECTV and some series like Kingdom and so forth.

And Simon, you should expect us to continue to engage at that level and as we have success, you'll see us invest more in the areas where we have success, but right now I think our plate is full doing full-scale integration of DIRECTV and bringing it into the mobility channel.

Operator

The next question in queue will come from Frank Louthan with Raymond James. Please go ahead.

Frank Louthan

Can you talk a little bit more on the mobility side about deals with Ford and so forth? Does that include getting just maybe beyond new cars but also getting into the used dealership networks? And then on the Mexico side, can you comment on your aspirations for video with those customers there?

Randall L. Stephenson

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

You bring up an interesting point and that is there is a massive used car fleet out there that is not connected and there is actually technologies that are now available. I have a sports car, old sports car that I now have connected to the Internet and it's actually a fairly elegant solution.

And so there are some capabilities that we are putting into the market, in fact we are selling into the market today, to connect the used car fleet that is out on the U.S. roads and we think that's important because the average age of a car on the road today is 11 years. And so if you really want to grow this business, you need to tap into the used car fleet. So that's a priority for us and you'll see us pursue that.

On Mexico, and as it relates to the video opportunity, we are fairly convicted that mobile and video are going to be a category that's very, very relevant in the U.S. and we're early on here in the U.S. but based on early success we continue to get more and more convicted, it is going to be an important category, bringing the two together is going to be important. And if it's going to be important in the U.S., we think it will be important in other markets and Mexico will be no different.

As you know, we have a minority share position in a satellite company in Mexico and hopefully we'll be able to do some partnering there but we do think the video combination with mobile is going to be important in all geographies in all markets.

Frank Louthan

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

Randall L. Stephenson

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

Operator

Our next question will come from Michael Rollins with Citi. Please go ahead.

Michael Rollins

Just two if I could. First, the management in the past has discussed the investments in broadband within the wireline footprint over the last few years. Is there a way you can size the footprint where you've made the upgrades but you are underpenetrated for broadband share and help us think about the gap you hope to close given the speeds that you are now offering? And then if I could just throw in a second question, I was wondering if you could share some of the segmentation of how you spent capital in 2015 capital expenditures specifically and how those allocations might change as you look at the 2016 budget?

John J. Stephens

Let me take a shot at this. With regard to our wireline footprint, we have about 60 million IP broadband enabled customer locations [indiscernible] from our consumer side and we've got about 15 million IP broadband customers today. So these are round numbers. The stat profile will give you the details. But with that, you can see that [indiscernible] penetration right now is about 25%. The key change here is the fact that we now have a national video product in DIRECTV and a satellite product, and such that we didn't have that before.

So many of our, if you will, broadband capable locations didn't have a video offering, now they do. And so as we improve this single [indiscernible] capability, this sales channel capability, all of that, we expect to grow that share and we would expect that it would be a significant improvement over where we're at today.

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

With regard to the capital spend, you are right, we don't go into great detail on the capital spend because in our wireline and wireless footprint and we are an integrated carrier, the spends become overlapping, whether you're taking high-speed backhaul to a sell-side or whether you are stripping wireless traffic or wireline traffic or an IP backbone.

But from a general perspective, in 2015 we spent probably about half of our capital in the wireless area, the other half in the wireline area, and if you will the [indiscernible] the shared services area. I will tell you that pickup in the fourth quarter in part was due to Mexico and in part was due to the set-top box and the sales opportunities in DIRECTV. So, I'll give you that way to think about it and I think that will be kind of a consistent story as we go through in the coming years. We are investing at a rapid rate in all of our businesses.

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

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

Randall L. Stephenson

Don't forget software defined networking continues to push capital requirements down over the next three or four years. We think it's going to be significant.

John J. Stephens

Tony, we'll take one more question.

Operator

And that will come from Timothy Horan with Oppenheimer. Please go ahead.

Timothy Horan

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

John J. Stephens

Tim, [we don't like to give that guidance] [ph] but let me say it this way. I can completely understand how Verizon or [indiscernible] a similarly situated company can get to that level.

Timothy Horan

Got you. Randall, clearly there's unprecedented technological change of cloud and artificial intelligence and everything else going on and you've had a lot of your peers slash CapEx and OpEx spending and Sprint seems like they are really on the road to doing that right now, but we've had a lot of European carriers do the same thing. I guess the question I get a lot is, how much of a focus is that at AT&T and do you have confidence that you can kind of see some of these benefits? And I guess maybe in that regard, I know you have Project Agile out there, any kind of update on where you are in that process and ability to cut expenses, that would be great?

Randall L. Stephenson

When you think about software defined networking, as you think about the merger synergies for DIRECTV, $2.5 billion run rate synergies, you think about all this going on and just the core business, you've got Project Agile John does where we are really just streamlining a lot of various operations, moving a lot of the customer interaction at their request to digital, the opportunity is really impressive to continue taking expense out of the business.

I would tell you, if you look at just this quarter's results, it ought to give you some degree of comfort in terms of what's possible, even at a company of our size and our scale. Whether it's Business Solutions segment, our Mobility segment, our Entertainment Group segment, consolidated – I mean it was a clean sweep in terms of taking margins up and we weren't taking them up 5 or 10 basis points, the margins really moved up considerably. And so we feel really good about the path we are on and the momentum we have on the cost side of taking cost out of the business.

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

The sensor technology, the ability to actually put in sensors at virtually no – I mean the cost is nominal to put these sensors in place. Millions upon millions of these sensors, all of these, these four elements coming together at one time is a massive opportunity and people are not thinking about how to take advantage of ubiquitous mobility, high-speed, low latency networks with cloud, with data analytics, with this sensor technology are going to miss it and we think we're at a place right now where we have a unique position on bringing all of this together and creating growth. We're going to invest through this cycle. We're going to invest in video and making sure we can deliver video to our customers, we think that's going to be a huge opportunity, and expanding our footprint into Mexico.

I mean all of these are converging we think to give us a growth platform for the next four or five years that is unique. So we're trying to be prudent, our downward bias on an incremental basis of capital. As we continue to emphasize that, we are being more and more efficient with our capital spend. John pointed out the implications of spectrum. Don't miss this. As you deploy these 2x10 MHz blocks of spectrum, the efficiencies it brings to building and operating mobile networks is significant and we think we're in a very unique position in that regard too.

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

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