Operator

Ladies and gentlemen, thank you for standing by and welcome to AT&T second quarter earnings release 2013 conference call. At this time, all participants are in 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, today's teleconference is being recorded.

At this time, we will turn the conference call over to your host, Senior Vice President of Investor Relations for AT&T, Ms. Susan Johnson. Please go ahead.

Susan Johnson

Thank you, Tony. Good afternoon, everyone, and welcome to our second quarter conference call. It's great to have you with us today. I am Susan Johnson, Head of Investor Relations for AT&T. Joining me on the call today is John Stephens, AT&T's Chief Financial Officer and Ralph de La Vega, AT&T's President and CEO for Mobility. John will cover our consolidated wireline results and Ralph will give us an update on our wireless business and then we will follow-up with questions-and-answers.

Let me remind you, our earnings material is available on the Investor Relations page of AT&T website. That's www.att.com/investor.relations. I also need to cover our Safe Harbor statement, which is on Slide three of the presentation. This presentation and comments may contain forward-looking statements. They are subject to risks. Results may differ materially. Details are on our SEC filings and on AT&T's website.

With that, 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 thank you for your interest in AT&T. Let me start with our consolidated financial summary, which is on slide four.

Consolidated revenue was a solid $32.1 billion, up $500 million or 1.6% on a reported basis and is up an impressive $800 million or 2.6% when you exclude the divested advertising solutions business. We were able to do this with no lift from the economy. These gains were due to solid revenue growth in wireless, strong gains in U-verse services and with improving revenue from our wireline business.

Reported EPS for the quarter was $0.71. That's up almost 8% over last year's second quarter. OUR results this quarter include about $0.04 lift from the sale of some of our América Móvil shares. You may recall that América Móvil shares. You may recall that América Móvil has a share buyback program underway and we were selling shares to maintain our ownership closer to our historic level of about 9%. When you exclude this help earnings per share were $0.67, our adjusted EPS is up about 5% for the year and up nearly 2% in the second quarter.

Consolidated margins were down year-over-year, primarily due to success based initiatives in both, wireless and wireline. Cash flow continues to be strong. Cash from operating activities for the quarter totaled $9.5 billion, which allowed us to have strong capital investment in Project VIP and still have free cash flow of $4 billion. And in the second quarter, we bought back about 90 million shares or $3.3 billion. And with our strong dividend, we returned more than $5.7 billion to shareholders.

Now let me give you the highlights for the quarter on slide 5. As you can see, we continue to execute at a high level. Our network performance is nothing short of terrific. We have posted impressive metrics across our key growth drivers. And as a result, we have improved momentum heading into the second half of the year. And as I said, we see this across our most important growth areas. That includes about 20% growth in mobile data, strong postpaid net adds and record-setting smartphone sales.

Total U-verse subs reached 9.4 million, while video subs topped 5 million customers for the first time. Total U-verse revenues grew better than 30%, and U-verse now represents more than 50% of consumer revenues. And even with little help from the economy, business wireline showed sequential revenue improvement and strategic business services grew by more than 15%. All this resulted in improved revenue growth, continued EPS gains and strong free cash flow even while investing more in our customers and in our Project VIP.

I now would like to turn the call over to Ralph de la Vega, who is going to update us on all the work going on in wireless. Ralph?

Ralph de la Vega

Thank you, John, and hello everyone. It's great to be with you today. Before we get to the wireless highlights for the quarter, I would like to take a moment to give you a quick update on our 4G LTE wireless network, which is now the nation's fastest and most reliable 4G LTE network. Details are on slide 6.

Our network team has done an incredible job with our LTE deployment. All LTE networks are not built the same. They all don't use the same network architecture, not all have the same network reliability and density and they all don't have the fastest speeds. Our goal was to build the best LTE experience from the very first market we deployed.

You can see by the high praise and recognition our network received that the results speak for themselves. PC Magazine called our 4G LTE network, the nation's fastest. PCWorld say we have the fastest average download and upload speeds of any competitor in its test for the second year in a row. And according to independent third-party data, we now have the most reliable 4G LTE network as well.

We already cover more than 225 million people with our 4G LTE network today and we are on track to reach nearly 270 million pops by year end covering 400 markets, and we continue to move fast with our 4G LTE deployment. We now expect to substantially complete our 4G LTE network by the next summer.

Customers love our LTE experience. We already have more than 35% of our smartphone subscribers on LTE, and that number is accelerating quickly. Thanks to our impressive line of LTE devices. The recognition is great to see, but this network also provides a solid foundation for wireless growth platforms and those details are on slide seven.

Having the nation's fastest, the most reliable network gives us an advantage when it comes to growth and the growth story is very powerful. Smartphone data usage is up 50% year-over-year and more than 70% of those devices are on usage-based plans with most taking larger data plans. This growth plus an increasing number of smartphone subscribers and new data devices being added to the network drives a strong 20% mobile data growth that we are seeing.

We also rolled out our first Digital Life market in the second quarter. We are now up and running in 33 markets and expect to be in 50 by year-end. I already have Digital Life in my home and let me tell you, it's really amazing what it can do. We believe, home security and automation is a large untapped opportunity for us.

An other opportunity is the Connected Car You already know our GM agreement to begin wireless connectivity for all GM vehicles in the U.S. market beginning in 2014. We have also announced an agreement with Sirius/XM satellite radio to provide mobile connectivity supporting a suite of security and services for Nissan Automobiles in North America and yesterday we announced an agreement with Audiovox to provide network connectivity to Audiovox's telematics and location-based service systems.

You also know of our recent moves in the prepaid space. We recently introduced a new prepaid service and the proposed Leap Wireless deal will accelerate our expansion in this segment. We believe we have the right strategies in place to make a stronger impact in the prepaid segment and think there is a strong growth opportunity there as well.

Finally, last week we announced AT&T Next, a program where customers can get a new smartphone or tablet every year with no down payment, no activation fee, no upgrade fee and no financing fees. This is a great program that provides great value and more choice for our customers. Many customers don't want to wait for the latest and greatest device and with AT&T Next, they don't have to.

Now, let's move on to our second quarter results starting with a look at postpaid net adds on slide eight. Led by solid gains in tablets, we added more than 550,000 postpaid subscribers in the quarter and that's a 72% increase from the year ago quarter and our best second-quarter postpaid net add quarter in four years. We added about 400,000 postpaid tablets, which we expect to be the largest gain of any carrier in the second quarter.

In addition, prepaid net add increase as a result of solid GoPhone sales. Total prepaid sales continued to be impacted by the migration of session-based tablets to postpaid plans which is a transition that we are happy to see. Gains in connected devices more than offset losses in the reseller segment where we saw subscriber losses primarily in low revenue accounts. However, reseller revenue increased by almost 30% year-over-year. Postpaid churn was up slightly year-over-year, but down from the first quarter and smartphone churn was even better, less than 1%.

Strong postpaid net adds helped drive solid revenue growth and those details are on slide nine. Revenues continue to be led by data growth. We saw nearly 20% growth in data revenues in the quarter and that helped to drive a 4.1% service revenue growth. Total wireless revenues were up nearly 6%. The growth of smartphones, tablets and other data devices is fueling this data growth. Mobile data is down nearly $22 billion annualized revenue stream for us.

This growth can also be seen in our expanding postpaid ARPUs. Total postpaid ARPU which includes tablets was up nearly 2% in the quarter but phone only ARPPU was up 3%. Our phone only ARPU includes smartphones but also includes our lower ARPU feature phones and wireless home phones as well which makes this growth even more impressive. Postpaid data ARPU grew at nearly 18%.

Smartphone sales were also strong this quarter and those details are on slide 10. A second quarter record 88% of our postpaid phone sales were smartphones. Smartphone subscribers now make up 73% of our postpaid phone base and that's an increase of more than 1.2 million new smartphone subscribers in the quarter. These are the premium subscribers in our business.

They have twice the ARPU of non-smartphone subscribers and much lower churn. We also set another second quarter smartphone sales record of 6.8 million, an excellent performance in a very competitive environment. This helped drive record Android smart smartphone sales, both in total number of phones sold and in the highest percentage of total sales.

Now we did this while also selling more iPhones than we did a year ago. Several promotions and our new low cost trading program helped to fuel these strong sales brining in new customers while also keeping existing ones on two-year contracts and it also increased the number of LTE devices on the network. More than 35% of smartphones now our LTE, the moved to usage-based data plans also continued in the second quarter.

Overall more than 70% of our smartphone base has moved to usage-based plans and data use on the smartphones is growing by about 50% year-over-year, so we have more smartphones on usage-based plans, data growth is strong and growing number of subscribers are taking bigger buckets of data from us. About 80% already take the larger data plans and we are seeing more than a quarter of mobile share accounts on data plans of 10 gigabytes or higher.

And speaking of mobile share, we now about 4.3 million mobile share accounts and those accounts include more than 13 million subscribers on devices such as smartphones and tablets and we continue to see a steady movement of subscribers on limited plans to mobile share. More than 15% of subscribers to-date moved over from unlimited plans, and remember that our customers have a choice. They can keep the plan they have or move to mobile share whatever plan that works best for them.

Strong postpaid net adds, smartphone sales and upgrades impacted margins and those details are on slide 11. Our wireless EBITDA service margin was slightly below our first quarter levels at 42.4%, but we sold 800,000 more smartphones in the second quarter than we did in the first. We made a strong effort to get people into our stores or on our website through promotions that allowed customers to trade in their phones and sign new contracts with us and that strategy worked extremely well.

Upgrades were much stronger than a year ago and the first quarter, and we had a higher percentage of customers on contract at the end of the second quarter than we did at the end of the first quarter. The long-term value they bring is impressive, higher ARPU, lower churn, strong data growth and greater network efficiencies from our new LTE devices.

The trade-in program also gave customers a chance to upgrade their phones before upgrade period moved to 24 months. At the same time, our new AT&T Next program gives customers the best choice if they want a new device every year. So, as you can tell, we were very busy this quarter introducing new programs and delivering a strong second quarter performance and you will continue to see us drive strategies to grow our business as we move throughout the year,

John, those were the highlights in wireless. And with that, I will turn it back to you to discuss wireline results.

John Stephens

Thanks, Ralph. I appreciate it. Now, let's look at our wireline operations starting with consumer, which you can see on slide 12. As I mentioned at the outset, we passed a crucial threshold with U-verse. It now accounts for more than half of all consumer revenues. Two years ago, U-verse was less than a third of consumer. Now it's more than half and growing very fast. That's a remarkable benchmark as we transform our business. We now have 9.4 million total U-verse subscribers. That's more than double the number we had just two years ago. We added more than 640,000 U-verse high-speed broadband subs in the quarter and 233,000 new U-verse T.V. subscribers, topping 5 million video subscribers for the very first time.

U-verse broadband now makes up more than 50% of our total broadband base with total broadband ARPU growing at more than 9% year-over-year. These gains helped drive overall consumer revenue growth of 2.4%, with total U-verse revenues up nearly 30% in the quarter. U-verse is now a nearly $12 billion annualized revenue stream. Not bad for a business that was just started seven years ago and it also shows clearly that we know how to build and scale new businesses as we move forward with Project VIP.

Now let's move to wireline business, which you can see on slide 13. The economy continues to be challenging, and it's not providing any assistance to our efforts here. But on the bright side, we do see some signs of improvement from the first quarter. Business revenue was down 2.2% year-over-year, but increased sequentially with both enterprise and small business showing sequential revenue growth.

Small business also showed growing customer momentum with U-verse broadband net adds. Part of the business continue to do very well. Growth continued to be strong in strategic business services. That's products such as VPN, Ethernet, hosting and other advanced IP services which were up more than 15% in the quarter. These services represent more than $8 billion annualized revenue stream and are approaching 25% of total business wireline revenues.

We continue to do well with wireless in the business space. We had our best ever wireless business adds in the quarter. More and more businesses want solutions that include wireless. For example, earlier today we announced an agreement with Disney Parks that makes AT&T, the official wireless provider for Walt Disney World Resort and Disneyland Resort.

We have talked often about the transformation of wireline from legacy products to advanced IP services but we are also seeing businesses transform to mobility. AT&T is well positioned to deliver these types of solutions to the business market. Our full ownership of our global IP network and our leading 4G LTE wireless network are a powerful combination when it comes to meeting business customers' needs.

Before we get to cash flow, let me give you a quick update on some of our Project VIP initiatives. Details are on slide 14. Ralph told you about the incredible progress, both quality and coverage that we are making in wireless, but we are also breaking ground on several wireline projects as well. Our network upgrades are on track and we expect to boost top U-verse speeds up to 45 megs per second in the next few months. We are moving towards speeds of 75 megs and 100 megs in the near future.

We have increased our U-verse video consumer locations by about 500,000 year-to-date. Those locations also include U-verse broadband. We have also added 1.3 million U-verse broadband only customer locations so far this year. When you add those together that's nearly 2 million new U-verse broadband locations to serve customers. This gives us more than 50 million U-verse broadband customer locations across our wireline footprint. We are on track to hit our goal of reaching approximately 75% of our customer locations within our wireline footprint with wired high-speed broadband by the end of 2015.

Our fiber builds to multitenant buildings is also underway. We expect to reach approximately 250,000 of our 1 million customer locations targets by the end of 2013, or just six months into our plan. But as you can see, we are making progress and we are very excited about the growth potential of Project VIP brings to AT&T.

Even with our progress on Project VIP plus success based initiatives, margins continue to be solid. Details are on slide 15. For the second quarter our consolidated operating margin was 19.1%, an increase from the first quarter but down year-over-year due largely to stronger actually record smartphone sales and higher costs associated with U-verse adds.

Wireline margins saw pressure from success based initiatives in consumer and Project VIP investment costs. Wireline pressure was partially offset by growth in consumer revenues, operational improvements in the network, sales and support functions and solid execution of cost initiatives. As Project VIP moves ahead, we will continue to look for more opportunity to reduce expenses.

Now, let us move to cash flow which continues to be a solid story for us even as we increase investment in our Project VIP. Our summary is on slide 16. In the first-ever year, cash from operations totaled $17.7 billion, which is up from last year's level. Capital expenditures were $9.8 billion as Project VIP investing starts to ramp and free cash flow before dividends was $7.9 billion.

In terms of uses of cash, net debt was stable in the second quarter with a debt-to-capital ratio of 46.6% and a net debt to EBITDA ratio of 1.6%, well below our guidance of net debt in the 1.8 range and actually slightly lower than our ratio of 1.68 in the first quarter.

We are [a second] 300 million share repurchase authorization and began buying shares back from the third authorization. However, the pace of buybacks slowed when compared to recent quarters. We repurchased about 89 million shares for $3.3 billion. With our dividend, this makes our total return to shareholders in the second quarter almost $6 billion. Even with our progress on Project VIP, plus success based initiatives, margins continue to be solid.

During the quarter, we also took several steps to strengthen our balance sheet. We continue working with the Department of Labor on our plan that would contribute to preferred equity interest in AT&T mobility to fund our pension plan. We are optimistic on the strategy and expect approval of this proposal later this year.

During the quarter, we monetized some of our shares of América Móvil soft while keeping our ownership levels roughly the same, about 9%. We continue to keep our focus on a strong financial foundation, our balance sheet is sound, our debt metrics are solid, our strong cash flow gives us the flexibility to invest in growth initiatives and make strategic investments such as Leap Wireless while returning substantial value to shareholders through our strong dividend.

Before we take questions, let me close with a quick recap of the quarter on slide 17. The second quarter was a story of growing revenues and growing momentum. Our revenue gains were strong, our cash flows were solid and we continue to grow EPS. The mobile internet drove strong wireless results, including strong mobile data revenue growth, growing postpaid ARPUs and our best second quarter postpaid growth in three years, plus our 4G LTE network has been winning praise and recognition for being the nation's fastest and most reliable.

During the quarter, U-verse hit an important milestone when it exceeded more than half of consumer revenues. And with project VIP, we feel the best is yet to come. Our strong execution this quarter puts us on track to meet our full-year guidance, including revenue growth, EPS, free cash flow and margins, so a solid quarter with strong momentum heading into the back half of the year.

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

Susan Johnson

Thank you, John. Tony, we will turn it back over to you to open it up for questions.

Question-and-Answer Session

Operator

Thank you very much. (Operator Instructions) Your first question in queue will come from the line of Phil Cusick with JPMorgan. Please go ahead.

Phil Cusick - JPMorgan

Ralph, I guess, if we could start with start with the net add number, can you just help us break it down a little bit 500 and something thousand, nearly 400,000 tablets. If you take out the on home phone sort of fixed devices and Digital Life, was there growth in mobile voice postpaid? Thanks.

Ralph de la Vega

Phil, thanks for the question. We had a really strong quarter in all aspects. And in fact, we ended up in June with significant gains in the smartphone only growth, not just wireless phones, so we feel this is one of the best quarters we could have turn in especially considering the fact that one of our competitors got the iPhone in the same quarter to churn in the performance that we did.

When you consider all the factors it was a remarkable accomplishments and we are very pleased with the overall phone growth, not just on smartphones but feature phones and wireless home phones and we have shown in the ARPUs that we have given you the fact that that even when you include all of those feature phones and wireless home phones, the ARPU is up in every nice way and the good thing about wireless home phones by the way is that soon there will be wireless homes phones and internet access.

In the next few days, you will see us announce that we will be adding data capability which will add substantial ARPU to wireless home phones and we think that's going to drive significant ARPU growth to the phone only category in the future.

Phil Cusick - JPMorgan

Okay, and then known, I guess, a second if I may, can you just help us a little bit on Digital Life. Just sort of round numbers for that. Was that single digit, double-digit, thousands in the quarter and how should we expect that to ramp through the rest of the year?

Ralph de La Vega

No, we are not providing that detailed information yet, Phil, but I can tell you that the early responses by customers has been very positive. The ARPU is higher than we had planned. They are adding a lot of video cameras to the services. With every video camera there is an additional charge. Customers love the product and net promoter scores are one of the highest that we have ever seen for any product that we have launched.

We announced recently that we added six new markets. That brings the total to 33, going to 50 by year-end. The platform is brand-new but its stable. It is taking all the load that we can give it. So, right now, we are cracking up the sales as we turn up market-by-market. I am very confident that our company-owned retail employees are going to do a bang-up job selling this product. So far what we have seen is a very nice lift and we are going to continue to increase our advertising spend to promote the product and continue to see it, I think, executed very well in the company-owned retail stores.

Operator

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

Mike McCormack - Nomura Securities

Ralph, or John maybe. Just some thoughts what's your tolerances for wireless margin pain? We have seen a lot of announcements from competitors recently. I am just trying to get a sense because if you look at the current guidance, you guys are talking of wireless margin expansion for the full year. Year-to-date, it stands at about 110 basis points. Maybe the change in upgrade policy could help the fourth quarter but just trying to think towards the back half of the year. How do you still thinking about the puts and takes? Thanks.

Ralph de La Vega

Thanks, Mike. Let me give it a shot and ask Ralph to join in. I will only give you a couple of push points here, reference points to start with. First of all, the change of the upgrade policy will certainly help in the second half of the year. Second, if you will AT&T Next, our new offering for our customers upgrade every year will also help. Third, its something we need to point out is that, as Ralph mentioned, our phone ARPU grew 3% this quarter. Actually more than 3%. We actually converted, we had actually 1.2 million smartphones this quarter.

Many of those conversions from feature phones which bring higher ARPUs. So we have got a lot of revenue momentum going on in the business. When you add that to the growth we are getting out of Digital Life, Connecting Cars and other things like that, one other thing that I will tell you, it is really strong and Ralph mentioned in his remarks, data usage is growing on a per device basis. Over 50%.

So as data usage goes up, we are seeing customers buy bigger buckets. Big tiers of data. So all of those things added together give us comfort that we will be able to meet the guidance we gave in January. I think those are the points, if you will, Mike, to look through this to say, how do we get from where we are at to where we expect to be by the end of the year.

John Stephens

Mike, there is one other point that I wanted to add because I think it is important to understand and I mentioned the advances that we have made with our LTE network deployment. What we are finding out is that the more we deploy LTE, the lower it costs us to produce a megabyte of data. So the cost structure in the future is something that I think as we produce more data it will be cheaper to produce it. We have over 90% of our backbone now being enhanced backbone, which means we typically have Ethernet to cell site.

So its Fiber Ethernet to the cell site with LTE with the radio head on the top of the tower. It's a very, very good architecture. When we executed like we are executing and it had the tendency to make it more efficient in terms of how you run the network up to 50% more efficient on the spectral efficiency as well, and so we feel really good about the infrastructure cost.

In addition to that, you have heard us mention that we started the process of turning down the subscribers onto our 2G network in order that we can turn off that network completely by one 117, and so a lot of work going on in the infrastructure, some of it being short-term, but also long-term as we turn down our 2G network that will be another source of margin improvement.

Mike McCormack - Nomura Securities

John, so you mentioned briefly regarding the third quarter initiative to increase U-verse broadband speeds. Is that something you are seeing? I mean, we are hearing a lot about Wi-Fi household in the home are you seeing and the huge explosion of usage in the home right now to drive sort of a need to accelerate that program?

John Stephens

The plan to implement that was really part of Project VIP and really was just to give a higher quality continuing to group quality of service to our customers. We are seeing continued demand for our U-verse product. And, as we mentioned, the 640,000 sales in what has traditionally been very slow quarter for us, seasonally slow quarter and we are over 1.3 million broadband U-verse net adds for the year, so we are continuing to see the demand. It just gets in with that program and with the overall project VIP strategy.

Mike McCormack - Nomura Securities

Okay. Makes sense. Thanks, guys.

Operator

Thank you. Our next question in queue will come from the line of John Hodulik with UBS. Please go ahead.

John Hodulik - UBS

Okay. Thanks. Two questions. First for John. The 1.67 leverage ratio, plus the Leap, you are getting up close to that 1.8 times target. Could you talk about whether that's setting store or if that could potentially change going forward. Then maybe update us on the possibilities for asset sales going forward and then I got a question for Ralph.

John Stephens

Sure. We are not changing our guidance. We feel really comfortable with the net debt to EBITDA and the 1.8 range and we are sticking with that. We believe that the cash flows we are generated from the business are going to be able to allow us to successfully manage to that, so we feel good about that.

I won't comment on any particular or specific asset sales, but I will tell you we do have a great collection of assets with the company, and we think it's our responsibility to manage those assets and manage the balance sheet. We believe that that management includes putting focus on working capital which we have done, lower our borrowing costs which we have done and monetizing assets as appropriate when we can do that.

I think you saw us do that in the second quarter with the cash proceeds we received for Yellow Pages and from América Móvil shares. And in both cases, we effectively retain the same ownership we had before, we generated that cash. So, we are going to continue that focus. But with that and with the balance sheet that we have and cash flows we have, we feel real good about sticking with our net debt to EBITDA in the 1.8 range.

John Hodulik - UBS

And then, Ralph, if you could talk a little bit about the Leap transaction, maybe the main drivers behind the transaction. And then if you could clarify the sort of prepaid strategy. It looks like you have two brands going forward. How aggressive should we expect you to be in that market and what the go-forward strategy is there?

Ralph de la Vega

John, the rationale behind the Leap transaction is basically to accelerate our entry into the prepaid segment much more so than we would have been able to do by ourselves. We plan to keep that Cricket brand and the distribution and I think that will ignite our growth into all aspects of the prepaid segment that I think has some really nice growth opportunities for us. So, that is our strategy. We will keep the prepaid brand at Leap brands with Cricket. I think it's a good brand and will leverage our distribution and that will fuel our entry in nationwide prepaid offerings.

John Stephens

John, I will tell you, let me add to it. What Ralph says is that I think what you will see is we are going to bring more competition and we are going to bring more choices to customers. And, the combination of Leap and our resources will bring an acceleration and a further deployment of that offering into that segment than either one of us could have done on the standalone basis. So I think this will be very good for the competition in the prepaid segment and we are really excited about the opportunity it provides us.

Operator

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

Simon Flannery - Morgan Stanley

A couple of questions. Ralph, the first, the 50% usage per smartphone device, it's pretty impressive. Can you decompose that into the change from people going to 3G, to 4G? Is that a big part of the growth? Then what kind, the 3G-on-3G, or the 4G-on-4G growth is?

Then, as you see more Androids in the mix, are you seeing a lower per device subsidy cost or a lower purchasing price for AT&T either now or is there some hope that you will be able to either subsidies or device purchase prices down going forward and lowering your equipment subsidy? Thanks.

Ralph de La Vega

Yes, Simon, I was really pleased to see the Android sales and they do carry a lower subsidy than some of the other phones we carry. We are seeing some nice opportunities as well coming up in the Windows Phone line with the Lumia 1020. That's a great device that, I think, is going to help to drive lot sales of Windows Phone. So we are really, really pleased with the diversity of the portfolio. That's increasingly more diverse up almost every quarter that goes by.

Now the thing about the usage, I think this is really a great highlight and I want to make sure everybody gets what we are seeing when we move customers from HSPA network to LTE, we see a significant increase in the usage of data. We also see them buy larger buckets of data. So more usage, buying bigger buckets and guess what, the net promoter scores on our LTE network are much higher.

So happy customers are buying more of our product and are buying in bigger quantities. I think that is what I see driving it and we are just getting started. What I love about the LTE network that we have built is it's getting great service but at the same time that that network is performing as good as any network, I think, on the planet right now, the more customers and usage that we move to the LTE network the better the HPA network performs.

So as a result, we are waiting in market after market where we deploy LTE. We are winning not just the fastest and most reliable 4G LTE network, we are winning on voice reliability, text reliability and better reliability. So I feel really good that we have prospects to continue to grow usage and to get customers to buy bigger buckets in the future.

Operator

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

David Barden - Bank of America

So two questions, if I could. Just the first one, strategic services had one of the strongest quarters it had in a really long time. I think you guys added maybe annualized $500 million of revenues this quarter in that segment. Could you talk about some of the drivers and whether those are going to continue and whether we can look for that growth out of that segment for the rest of the year?

Then, the second question would be, obviously you have talked a little bit already on the call about the changing nature of competition as we look in the back half of the year. Verizon, for its part, is suggesting that they think they can not just keep share but take share as the increase postpaid subscribers in the second half of the year. Obviously Sprint and T-Mobile have their ambitions. Could you kind out map out what is AT&T's position on balancing market share margin? What should we be expecting from AT&T as an objective function for the business? You don't have to tell us the strategy but what do mean managing this business to in the second half of the year would be helpful. Thanks.

John Stephens

That is great, thanks. Let me take a shot at it and I will ask Ralph to join in. First and foremost on strategic services. We are just saying that there is an acceptance across business for VPN, Ethernet, hosting and those high quality IP services. We are specifically seeing an improvement in our small business high-speed broadband.

I think we have noted in our presentations there were 81,000. That's a quarterly record for us in our small business customers. So even in a difficult economic situation and a challenged economic segment, we are seeing customers willing to upgrade to higher quality speeds.

With that, we also have a focus from our sales team and our sales effort on strategic services. They are really performing well and last year, I will tell you that with Project VIP, we are really now beginning to address the opportunities buildings which we are now taking fiber to and selling into those customer locations as we start the build process and we start making progress.

So its all of those things, David, but in summary, it's a real focus and it's an acceptance by customers of the value of those strategic services, even in some of the challenged spaces of the business segment.

Specifically with regard to wireless, as we have shown this quarter, we are going to compete. We are generating good margins. We going to improve those margins in the second half of this year. But we are going to be able to compete. I will give you one just simple point. In this quarter where a new competitor got the iPhone on a sequential basis, our churn is down. So I think we need to put it in that focus

So, I think we need to put it in that focus, our churn is down even in this quarter where a new competitor comes in. And even with all the new offerings that we are putting forward, so we will be ready to compete, we are going to be smart about it, we are going to be customers-focused about it and quite frankly we believe that our network superiority is going to lead us to be able to perform very well in the second half of the year and quite frankly for years to come.

Ralph de la Vega

Dave, I would like to add a couple of views here. First, let me speak about the postpaid segment. I don't think we have ever been better positioned in the postpaid segment than we are today and that's basically driven by the network performance that is the best than has ever been, winning awards right and left, just providing outstanding performance and as the LTE networks gets all those awards, as we move customers there, the HSPA network gets better. So, from a network perspective, which is a key driver of churn, I don't think we have ever been better positioned.

Our network team has done a great job and you can see dramatic improvements in drop calls and it's just a great, great story. In addition to that, we continue to find ways to differentiate on devices. We just are about to rollout the Nokia Lumia 1020, which I think is an exceptional device. We also launched earlier this year, the Samsung Active, which we call Whatever-

Proof pone, and so great network, great devices and great service differentiates us at the postpaid segment.

In the prepaid segment, I mentioned that our GoPhone sales were on the rise and that as a result of an upgrade in the platform that now finally allowances to sell LTE devices on the GoPhone platform and those sales are doing very well as we populate the GoPhone family with state-of-the-art devices that prior to this we couldn't turn on GoPhone platform.

So, GoPhone sales were doing very well, our prepaid services that we recently launched is doing well and now with Leap and the Leap acquisition, I don't think we have ever been better positioned on the prepaid segment, so I like our position positioning for the second half of this year better than almost any second that I have faced in recent history.

In addition to all of this, as we move our data growth into LTE, it's improving our cost structure and we feel good about that. So I think as you look at, we are really in the best shape that we have been heading into a second half that I have seen for a while.

Operator

Thank you. Our next question in queue will come from the line of Jason Armstrong with Goldman Sachs. Please go ahead.

Jason Armstrong - Goldman Sachs

A Couple of questions. Maybe first on handset trade-ins which are obviously said to be a little bit bigger part of the model going forward. I think, John, you talked about Next helping wireless margins. Maybe if you can offer some more context around it? Maybe a framework for volumes you would expect here and what you can make on a resale or refurbed device from a margin perspective?

Then second question, Verizon, I think talked about promotions at third party distribution channels negatively impacting wireless margins in the quarter. I am just wondering if you saw something similar to this that you would call out? Thanks.

John Stephens

Well let me try the Next question and I ask Ralph to join in. The way I view it is simply this. In the marketplace for the last few years there have been high quality used phones that neither the customer nor the provider, the transport provider have taken advantage of their value. So when someone comes in for a new phone they often ignored and maybe head it out, but they don't necessarily capture the value.

What Next allows the customer to do is by bringing that phone and a high quality phone that still has some value, giving it to us, it lowers their cost to getting a new phone every 12 months. So they get value for it and then we have a network of capabilities whether using our refurbishing and our insurance business, whether we resell to a wholesaler or whether we resell it in our stores.

So we are able to capture that value. Up to this program, it hasn't been a captured value, and as you all know, those phones, many of the phones could have a $200 or $250 value. That's what makes this project work. That makes this offer work for both the customers and for us.

Ralph de la Vega

Jason, there was a news once that we did that really drove the volume of trade-ins something like 500% to 600% compared to the prior period. The key was for customers to realize that they didn't have to worry about what they were going to get for the handset. If they brought us a handset that was within three years old and good working condition then we would give him a $100 off. All of a sudden they didn't have to worry about going in checking what it was worth. We would guarantee them that price.

We actually took the risk in what the value of that trading would be. As it turns out, when they actually start to trading them in, the value of the phone that they were trading in was much higher than what we had anticipated we were going to get. So it was good for the customer. It assured them that they could had a get a certain amount for it and for us, it turned out to be a good strategy.

In addition to that, Jason, when we lead out our AT&T Next program, we knew that in order for that program to work well, we had have to have a very good trade-in program. So the trade-in program preceded AT&T Next and appropriately so, so we can get customers educated on the value of the trade-in, so we could get our reps to process it and now it's part of the AT&T Next program and I think it's going to hit with all cylinders firing as we have really educated the customers and our reps on how to process and do trade-ins.

Jason Armstrong - Goldman Sachs

Great, and then the third-party?

Ralph de la Vega

I am sorry. On the third-party distribution, yes, we did see some upgrade activity through our third party distribution that's usually a little bit more expensive. But I would say that that wasn't the big driver for us. It was essentially the volume of upgrades that were done in the quarter that drove the pressure and the margins that you saw.

Operator

Thank you. Our next question in queue will come from the line of Amir Rozwadowski with Barclays. Please go ahead.

Amir Rozwadowski - Barclays

Ralph, I just wanted to follow-up on some of the discussions around your recent promotion plans. While I recognize it's still early stages, how successful have these plans been in helping to manage equipment cost and ultimately fuel your belief in hitting your margin expansion target for the back half of the year? I am thinking about the extension of the upgrade cycle here. I guess we are just trying to understand the different drivers here given your comfort and sort of your guidance.

Ralph de la Vega

Well, before we introduced AT&T Next, we did a lot of customer research and there was overwhelming support for program just like the one that we have launched. We actually launched the program early in a couple of markets and their response has been good.

We are feeling real positive about the impact that this could have both, on customers and our financials, so we are full speed ahead, but I think the key with the program as we heard from customers is they essentially wanted to upgrade their phones in a yearly cycle, which is typically when they get refreshed and they wanted to do it with minimal outlay. And the fact that we can do that now for our zero down, no upgrade, no activation fees and no finance fees, means that you can actually walk out the door with a Lumia 1020 device with a 41 megapixel camera the best of the best in camera technology with zero money down and a very reasonable payment.

So, I think that is what gets me excited knowing that we can put that kind of technology in the hands of people and that they will enjoy it, but part of the process there was to get a trade-in program that was workable and we have done that already as a result of the promotions that we have launched. And by the way, because of our large base of iPhones, we stand to gain the most, because the value of those smartphones is the highest.

Amir Rozwadowski - Barclays

That's very helpful. Thank you. Then John, just had a question on your capital deployment strategy. You mentioned that your plan is to be opportunistic on your buying back going forward. Clearly, you are focused on finishing the Leap deal. Where can we see other areas of capital deployment in sort of near-to-midterm, perhaps I guess the way to look at it is, what are your strategic priorities for capital deployment here?

John Stephens

Clearly, our strategic priorities, two things in the short-term here is finishing off our Project VIP for us this year, which includes our LTE and additionally U-verse and fiber to building built all those aspects of VIP. Then secondly being prepared to close the deals we have in place before the SEC with regard to some of the spectrum deals, whether it'd be tuck-in or whether it'd be spectrum deals. Then third to be have all of that done where we still can very easily which is something we are very confident we can accomplish close the Leap deal whenever that becomes available, so those are our priorities, if you will.

I have said this before and I will say on this call. Our dividend is clearly a sacred matter for us, we clearly understand as managers of AT&T, the importance of our dividends to our shareholders. That's never a question, and so what we do after we have taken those responsibilities satisfying those responsibilities, but those are the order of things. And, with our strong cash flows, we will continue to have opportunities to buy back shares. We will just be opportunistic as we go through that.

Amir Rozwadowski - Barclays

Great. Thank you very much for the incremental color.

Operator

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

Timothy Horan - Oppenheimer

Thanks, guys. I have two questions. Well, first, John, it seems like the underlying strength in the quarter was really somewhat driven by the improvements in the networks both, wireless and here on wireline.

Would you maybe think about accelerating velocity or extending out a little further to maybe upgrade the networks a little bit more given what we are seeing is really great in the quarter in terms of acceleration growth and volumes? And then a follow-up for Ralph.

John Stephens

Sure. Tim, I agree with you. The performance by network team in both, wireless and wireline has been exceptional and finding good quality service to our customers is always key to success. With that being said, we are in a position from our balance sheet to fund things on an opportunistic basis and as we can get them done efficiently. I think that's what you saw in the second quarter with our CapEx stepping up to near $5.5 billion range, but $900 million higher than last year and higher than the first quarter. We spent that money at this time, because the network team could get more done and efficiently get it done and so we want to make sure we fund that and we will stick to that philosophy.

With that being said, I still believe we are going to be in the $21 million dollar range for our CapEx for this year. I think the network team has continued to outperform all aspects of their LTE build. We had originally targeted 150 million for last year we finished near 175 million. I think Ralph mentioned today that were 225. So I feel very comfortable that we going to be near 270 by the end of this year.

We are expecting to substantially complete the whole build by the middle of next year. So we are doing exactly what you are suggesting in the wireless space. In the wireline space, we are going through the same process. So we are not afraid to go faster. We are just going to do it prudently and we are going to do it efficiently. So let me ask for your next question for Ralph.

Timothy Horan - Oppenheimer

Thanks. Ralph, just only two small ones. Have you seen a slowdown at all in the iPhone impact that T-Mobile has had on you? It usually lasts about a quarter or so? When do you expect that to hit? And then secondly, I guess on wireless data, are customers starting to bump up against our caps in a way that with the pricing lead to maybe some elasticity? Are you worried about that at all or seeing that at all? Thanks.

Ralph de la Vega

Okay. First, on the iPhone impact. We have seen what, in terms of T-Mobile and then getting the iPhone, the same impact that we saw when Sprint got the iPhone and when Verizon got the iPhone. There is usually a spike in the timeframe that they get the iPhone. Then it comes back down. Quite frankly, the spike that we have seen from the T Mobile getting the iPhone is significantly less than the spike that we saw with Sprint and the spikes that we saw with Verizon. My expectation is that they will continue to come down overtime. So that's kind of where we stand today.

In terms of wireless data and people hitting the caps or bumping against them. We are not seeing a lot of that. What we are seeing, which is part of our strategy all along, Tim, is we know that there is an explosion going on with tablets. Our firm believe, all the time, was we needed to get mobile share out in the market place, so customers could easily add a tablet and at the time they add the tablet, then the increase to size of the data bucket. That's exactly what is happening.

So as customers add tablets, they are being smart enough to add or to increase the size of the data bucket and so we are not seeing anything at this point that gets me concerned, especially from a customer satisfaction point of view in terms of usage. Customers are being smart. They can monitor their usage now more than ever before. They are being cautious to make sure they don't have overages.

So I really think that this is huge for us and that's why you saw the emphasis that we have on getting tablets. Those tablets are getting added to the network. Data use is just going up. The size of data buckets is on the rise as well.

John Stephens

As Ralph had mentioned, 80% of the customers we have on tiered data programs, 80% of them are picking the higher tiered buckets of data. So they are buying up and we are pleased with our mobile share where over 25% are buying the 10 gig bucket. So it is working out just as Ralph mentioned where these customers are buying those bigger buckets and generating that revenue which is generating our service revenue growth and it continues to have great ARPU growth on our phones.

Operator

Thank you. Our next question in queue will come from the line of Michael Rollins with Citi Investment Research. Please go ahead.

Michael Rollins - Citi Investment Research

Just a couple of clarifications, and then maybe one higher level question. First, is it possible to break out the dilution that you are seeing from VIP from an operating perspective, both for the second quarter and for the full year '13? The second clarification is, last quarter you talked a lot about the impact of U.S. debt on the revenue. I was wondering if you can give us an update. Was that also a headwind in the quarter or was there any help from the U.S. debt? Just maybe directionally how that changed from the first quarter to the second quarter? Thank you.

John Stephens

Yes, Mike, this is John. Let me take the second question first and that is, the out of balance situation with U.S. separate those rates being different from last year to this year. The same situation occurred in the second quarter at about the same level or about the same amounts in the same relationship as it did in the first quarter. So our numbers that we reported to you are overcoming in that pressure, both on the wireless side and the wireless ARPUs and also in the wireline side for both, business and consumer. So, there is no change in that situation. We have overcome and these numbers that have been reported.

Michael Rollins - Citi Investment Research

Then on VIP?

John Stephens

On the breakout, we don't do that, Mike, but let me say it to you this way. If you look at our CapEx spend on a year-over-year basis for the quarter and on the sequential basis for the quarter, it's about $900 million in both cases increased. We don't give a trailing expense impact on our capital, but I will tell you that even our construction project have some level of trailing expense. Then quite frankly, our software projects have a much higher level of trailing expense.

The pressure for the quarter really relates to what I would view it is that $900 million increase times whatever percentage you would apply to it. I would suggest you that numbers could vary in anywhere from 10% to 20% to 25%. We are not going to get into what ours are specifically, but I don't think in the industry those kinds of percentages will be unusual. I will leave it to you guys to determine your own.

Michael Rollins - Citi Investment Research

Then just one higher level question on the wireline business and also the sort of prior to the enterprise business, so you have talked about in the second quarter that you stepped over that line where you had sequential growth, albeit, still down year-over-year. And I feel like, if you go back historically, we have crossed that line into positive sequential before, but we have been brought back to that negative territory for a variety of factors from time-to-time, whether it was USF, whether it was the legacy parts of the business.

In addition to your comments on the strategic services, are there aspects of what you are seeing in the legacy or other aspects of your portfolio that make you believe that the step over to positive sequential growth could be more sustainable on a one or two year basis?

John Stephens

Yes. Let me give you two different perspectives on that. One on our consumer business, that now greater than 50% U-verse, that was growing nearly on the consumer U-verse pace nearly just below 30%. I think the math will show you that when you have got now more than half of the business growing somewhere between 25% and 30%, is a more sustainable situation than it was a year ago or two years ago when that was percentage of the business 40% or maybe a third, so the math is different with regard to consumer, because that base is so much bigger and so much bigger piece.

On the business side, I agree with you. The economy has given us challenges. We are pleased that we have gotten our strategic business services up to nearly 25% of our business revenues, but the economy is still uncertain. Such that we are not in that same point and that is why we mentioned that we were slightly positive on a sequential basis and we will have to see how this plays out the rest of the year.

The one encouraging piece there is what we mentioned in small business and how well our team has done in beginning to put U-verse or high speed broadband into our small business space and the 80,000 high speed broadband net adds they had this quarter and we are optimistic about what we can do with that going forward. Particularly, when you look at our trend that's a highest quarter we have had on record and significantly better than the first quarter or the fourth quarter of last year.

Susan Johnson

Tony, I think we have got time for just one more quick question.

Operator

Thank you. And that question will come from the line of Jonathan Chaplin with New Street Research. Please go ahead.

Jonathan Chaplin - New Street Research

Thanks very much. Two quick questions if I may. First of all, you may have mentioned this earlier, but I didn't hear it, give us a number of iPhone sales in the quarter? Secondly.

John Stephens

Jonathan, I would just say no we are not disclosing that number, but I think we disclosed the total number in our slide presentation. Our smartphone sales of 6.8 million and I think we have disclosed that we had a record Android sales, but we are not giving the specific iPhone number.

Jonathan Chaplin - New Street Research

Got it. Okay. Then could you give us a little bit more detail, John, just around the synergies that you expect from the Leap deal and how quickly you expect to be able to realize those?

John Stephens

Well, let me say this. We will get into synergies and realizations and all of the normal impacts that we discuss as we get the deal closed. So we are not going to be in the position to talk about those now. We are confident. We are expecting that the transaction is going to get closed after the government carries out its responsibilities and there is a fair review.

I will tell you, we are looking forward to getting this done. We believe that Leap is going to provide us the opportunity to expand services to customers and a segment of the mobility market that is now under served. So we are excited about it. We believe it's going to be a positive but we are going to wait and let the DoJ and the SEC go through their normal review process.

Ralph de la Vega

Thank you. Let me close down. I want to thank you for being with us this afternoon. We have delivered a solid quarter with strong subscriber gains, growing revenues and improving networks. At this time we are going to continue to invest in our business with our Project VIP and we believe it is on pace to provide us even more opportunity going forward.

With that being said, we think this gives us a strong momentum as we head into the second half of this year and into the years to come. So we are very excited about where we are at in our business. We believe our plans are playing out well and we look forward to talking to you in the future.

Thank you very much for being on the call and as always, thank you for your interest in AT&T. Have a good evening.