Operator

Ladies and gentlemen, thank you for standing by and welcome to the AT&T Third Quarter 2012 Earnings Release. (Operator Instructions) As a reminder, today's call is being recorded.

With that being said, I'll turn the conference now to Susan Johnson. Please go ahead.

Susan Johnson

Thank you, John. Good morning, everyone, and welcome to our third quarter conference call. It's great to have you with us this morning. I'm Susan Johnson, Head of Investor Relations for AT&T. Joining me on the call today is John Stephens, AT&T's Chief Financial Officer, and Ralph de la Vega, AT&T's President and CEO for Mobility. John will cover our consolidated and Wireline results, and Ralph will give us an update on our wireless business. Then we'll follow with Qs & As.

Let me remind you our materials are available on the Investor relations page of the AT&T website that's www.att.com/investor.relations.

I always need to cover our Safe Harbor statement, which is on Slide 3. This presentation and comments may contain forward-looking statements. They're subject to risks. Results may differ materially. Details are in our SEC filings and on AT&T's website.

Before I turn the call over to John, let me quickly cover our consolidated financial summary, which is on Slide 4. Reported EPS for the quarter was $0.63, $0.02 higher than last year's third quarter, and when you exclude our divested Ad Solutions unit we are up $0.03 or 5% for the quarter and 8% year to date. Revenue growth continues to be solid. When you exclude the divested Advertising Solutions business, consolidated revenues were up 2.6% year-over-year thanks to strong revenue growth in Wireless, continued gains in U-verse Services and growth in strategic business services.

Consolidated margins were down slightly year-over-year due to higher smartphone sales. And cash flow was very impressive. In fact, it was at record levels. Cash flow from operating activities for the quarter totaled $11.5 billion. And free cash flow was $6.5 billion. We aggressively bought back shares as part of our repurchase program. Through the end of last week we have bought back more than 271 million shares for $9.4 billion.

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

John Stephens

Thank you, Susan, and good morning, everyone, and thank you for being with us today. Before we get to the detailed results, let's start with a quick overview. Highlights are on Slide 5.

During the quarter, we continued doing an excellent job of growing the business, transforming our revenue streams, and improving our cost structure. We had solid revenue growth, consolidated Wireless and Consumer Wireline. We grew earnings, and we had our best free cash flow ever, both in the quarter and year to date. We also took a significant step to improving our funding status for our pension plans.

Last week we filed an application with the Department of Labor that seeks authorization to voluntarily contribute a $9.5 billion preferred equity interest in AT&T Mobility into the Pension Plan Trust. We see this is a win-win situation for investors, our employees, and our retirees. This will increase funding well above the required level by law and further assure the long-term health of our pension fund. We will collaborate with the Department of Labor to provide any details it might need, and work to obtain approval before the end of 2013.

As we look at our operations, Wireless had another strong quarter. Ralph will give you more details in a moment, but the headline was strong revenue growth led by the Mobile Internet, including our strongest post-pain ARPU growth in six quarters. And U-verse continues to be a great success story for us. We continue to add subscribers at a rapid clip. We now have 7.4 million total U-verse subscribers, both TV and high-speed Internet. This drove our ninth consecutive quarter of consumer Wireline revenue growth and our strongest growth in more than four years.

So the team is executing at a high level. Financial results are solid. We've taken steps to improve our capital structure, and all this puts us in a great position to continue delivering strong results as we finish the year.

Let's now take a look at detailed results starting with consolidated revenues on Slide 6. As you know, the sale of our Advertising Solutions business was completed earlier this year. If you exclude Ad Solutions, consolidated revenues were up $0.75 billion, or 2.6%. The drivers are Mobile Internet, strong performance with U-verse and continued strength in strategic business services. These growth drivers now account for 81% of our revenues in the third quarter. That's up from 78% a year ago and 75% two years ago. This is up about $1.5 billion, or more than 6% year-over-year. We expect this mix shift to continue as we sharpen our focus on our growth drivers and continue to successfully transform our business.

With that, I now would like to turn the call over to my good friend Ralph de la Vega, who will give us a Wireless update.

Ralph de la Vega

Thank you, John, and good morning, everyone. It's great to be on the earnings call once again. Before we get to the Wireless highlights, I'd like to give you a quick update on some strategic moves we made during the quarter that position us for future growth; details are Slide 7.

First, we introduced Mobile Share, our new data plans that allow customers to share buckets of data with up to 10 different devices; second, we accelerated our LTE build putting us ahead of schedule with our deployment plans; and finally, we announced an incredible new portfolio of 14 LTE devices that take advantage of that network including the launch of the iPhone 5. Let me give you a quick overview on Mobile Share.

Since we first offered this in August, we have been really excited with the results. Customer response has been incredible, early take rates have been impressive, and in fact more than a third of Mobile Share subscribers are choosing the larger data plans of 10 GB or more. Plus, all customers love having the choice to take Mobile Share plans, keeping what they have, or choosing from one of our other usage-based data plans.

Now let me provide more detail on our LTE deployment with our network update on Slide 8. We made tremendous progress with our LTE deployment in the third quarter. We're well on pace to more than double our LTE coverage this year, already reaching more than 135 million pops. Download speeds for LTE network have been blazing fast with speeds up to 12 Mb per second, and in many markets average download speeds are even faster. You can see this LTE speed boost with our Android devices where average download speeds have increased more than 50% since the first of the year.

With our combined LTE and HSPA-plus networks, we also have the nation's longest 4G network, covering more than 285 million pops and thousands more cities than our closest competitor. On our 4G HSPA-plus network, we're seeing download speeds of 2 to 6 Mb per second. And AT&T let's you talk and surf at the same time on the iPhone 5 and on all of our LTE smartphones.

We've also made improvements on all of our voice metrics. Our overall voice quality improved by 16% year-over-year, and our dropped-call rate also improved by 34%. Having a great network and stable stakes in our industry, and I also believe that we have the best selection of devices. The devices that we're introducing in the fourth quarter are on Slide 9. Our lineup for the fourth quarter includes several devices using the new Windows 8 operating system including our exclusive Nokia Lumia 920 and Nokia Lumia 820.

We will also be the only carrier offering new Windows 8 tablets from ASUS and Samsung. We also added great Android devices to our lineup, the HTC One X and the LG Optimus G. And it's not just smartphones and tablets. We also offer the Samsung Galaxy camera, which allows you to shoot, edit and share photographs and video easily and quickly without connecting to a laptop or PC, and we'll soon introduce the new My Five Liberate by Novotel, their first mobile hotspot with a touch screen display. Plus, we're the exclusive 4G LTE provider for the new Kindle Fire HD. Altogether we're bringing 14 new LTE devices to our product lineup arriving just in time for the holiday season.

But before I get too far ahead, let's take a look at this quarter's wireless results with a look at revenue and ARPU Slide 10. Our leadership in the Mobile Internet continues to drive solid revenue results. Total Wireless revenues were up 6.6% in the quarter and Service revenues were up 4.5%, our best performance in five quarters, thanks to another great quarter in Data.

We also had our best post-paid ARPU growth in six quarters, growing at 2.4% and phone-only ARPU was up almost 3%, and that's going off a much higher ARPU base than anyone else in the industry. Helping drive that growth is our expanding postpaid smartphone base. We have now nearly 45 million of these valuable subscribers in our network and smartphone sales continue to be strong. About 64% of our postpaid base has smartphones now with smartphone sales making up more than 80% of postpaid sales. The smart phones subscribers and driving strong data growth and those details on Slide 11.

Data revenues for the quarter were $6.6 billion, that's up more than 18% or $1 billion year-over-year. Data revenues are now at $26 billion, annualized revenue stream for us. And helping drive this impressive growth was another strong quarter for smartphone sales as customers continue to migrate to these devices. One of the reasons for strong sales was the introduction of the new iPhone. But we also sold a record number of Android and Windows phones in the quarter.

We sold 6.1 million smartphones in the quarter, and that compares to sales of 4.8 million a year ago, third quarter. We've added 1.4 million high-value smartphone subscribers in the quarter and more than 8 million over the past year. We also had another successful iPhone launch quarter. We had 4.7 million activations this quarter with about 18% of those subscribers new to AT&T and our iPhone 5 sales were about twice that of our closest competitor.

We also continue to bring in more subscribers onto our network with usage-based data plans. More than 28 million or about two-thirds of our smartphone subscribers are on usage-based plans. That's 10 million more than a year ago. Our mobile share plans are going strong and early sales have been positive. Nearly 2 million subscribers have signed up for mobile share plans in the first five weeks they have been available and take rates on the higher data plans are stronger than expected. More than one third of our subscribers are taking plans of 10 GB or higher. And about 15% of the new mobile share subscribers are changing over from unlimited data plans.

Let's take a look at churn and subscriber gains on Slide 12. Those pictures also improved year-over-year to 1.08% continuing positive trends. In fact, that's our best ever third quarter postpaid churn. And smartphone churn is even lower, less than 1%, even with the new product launch. One reason for the lower churn is the large number of customers on family or business plans and the newly launched mobile share plans. This continues to be a strong point with almost nine out of ten smartphone subscribers on one of these plans.

These customers tend to be sticky, with churn well below our average. We continue to add new customers, about 700,000 total net adds in the quarter, and our post-paid net adds were 151,000. We had a record number of iPhone pre-orders and tremendous customer demand in the 10 days of the quarter that the device was available, but we face significant supply constraints on the iPhone 5 in the third quarter, which clearly effects our net adds.

We have by far the largest base of iPhone customers, and each time there's a new iPhone we see strong and immediate demand for it. But given the limited supply, the vast majority of third-quarter iPhone sales went to existing customers, where there was considerable pent-up demand. We anticipate that as we received additional iPhone inventory, the percent of gross adds for smartphone sales will increase as they have in past iPhone launches. We also anticipate a higher number of net adds from tablets in the fourth quarter.

Now let's look at Wireless margins. Details are on Slide 13. This quarter's iPhone launch 5 impacted margins compared to a year ago. These are premium subscribers for us and they bring lower churn, higher ARPUs and strong data growth. But at the same time, we've taken several steps to support margins even with strong sales. This includes our new upgrade policy and we're just now seeing the full impact. Even during an iPhone launch quarter, upgrades held steady at about 7%. And we had changes in upgrade fees and early upgrade charges. These changes, as well as more smartphone sales, help drive a 28% increase in equipment revenue. And you see these initiatives paying off this quarter.

Two years ago, we sold about the same number of smartphones that we did this quarter, but our margins this quarter were more than 300 basis points higher. And nothing shows the value of our smartphone base better than that. As we head into the seasonally strong fourth quarter, we expect continued strong sales of smartphones. But even with these expected sales, we're on track with our original guidance to improve margins over 2011, targeting 40%. Year-to-date service margins now stand at 42.5%. We're really excited about the momentum in our Wireless business, our growth opportunities and the many great devices that we're launching in our blazing fast LTE network. With that, John, I'll turn it back to you to discuss our Wireline results.

John J. Stephens, Senior Executive Vice President and Chief Financial Officer

Thank you, Ralph. Now let's move to Wireline starting with Consumer, which you can see on Slide 14. Consumer turned in another solid quarter. Revenue growth continues to accelerate. We had 2% revenue growth in the quarter, our best performance in more than four years and are ninth consecutive quarter of growth. Once again, the story here is the incredible growth of U-verse.

U-verse is now a $9.5 billion annualized revenue stream, growing at more than 38% year-over-year. We now have 7.4 million total U-verse subscribers as both video and high-speed Internet. That includes 4.3 million video subscribers with almost 200,000 added in the third quarter alone. And we added more than 600,000 U-verse broadband subs in the quarter.

Bringing our total year to date to almost 2 million. This increase in U-verse broadband subs helped drive total Wireline broadband ARPU up almost 10% year-over-year. U-verse has transformed our consumer revenue mix. IP revenues now account for 59% of consumer revenue, up from 51% a year ago and 43% just two years ago. And IP revenues continue to grow at more than 17% year-over-year. The success of U-verse establishes our ability to compete and gain share and gives us confidence as we continue the transformation of the Wireline business.

Now let's move to business on Slide 15. This quarter's results continue the trends we began to see last quarter. Wireline business revenues were down 2.6% this quarter. That compares to a decline of 2.2% in the year-ago third quarter. Last quarter, we talked about some business customers being hesitant to pull the trigger on buying decisions due to concerns with the economy. And this is essentially what we saw this quarter as well.

There are many reasons for this. There's a slowdown in government spending. There's uncertainty over tax policy, and real concerns over the fiscal cliff. So overall, just a lot of uncertainty clouding business decisions. We, like every other business, hope to have some clarity soon. But in the meantime, we continue to focus on growing the parts of the business where customers are investing, such as on productivity, while at the same time keeping a tight control on spending.

Strategic business services, that's products such as Ethernet, VPNs and application services were up 11.4% for the quarter. And data revenues continue to grow even in this challenging environment. IP data revenues were up more than 3% year-over-year. Business Wireline margins also improved year-over-year, thanks to an excellent job by the business team of keeping expenses in check. So we have some bright spots even in a challenging economy. But we look forward to more clarity in the economy to get this business growing again.

Now let's look at margins and cash flow. Consolidated margin comparisons are on Slide 16. As you can see, strong smartphone sales had an impact on our consolidated margins as well. For the third quarter, our consolidated margin was 19.2%. That compares to 19.8% in the year-ago quarter, which did not include an iPhone launch. And if you look at year-to-date consolidated margins, we are ahead of last year's pace. Wireline operating income margins improved from a year ago, helping offset declines in legacy services were improving revenue trends in Consumer, solid cost management, and execution of our One AT&T cost initiatives.

We also made progress on several contracts with our represented employees. We reached an agreement with the Midwest region in the Legacy T contracts. We also reached healthcare agreements with 40,000 mobility employees. And we continue to work on contracts with the other regions. One of the innovative features in our approved contracts is our success-sharing plan. While this plan does increase costs, this quarter and year-to-date, it's worth it as it better aligns our Wireline workforce with our shareholders.

Now let's move to cash flow, which is a great story for us this quarter. Our summary is on Slide 17. Through the first nine months of the year, cash from operations totaled $28.9 billion. We are meeting and exceeding our build targets with capital expenditures at $13.8 billion, with more than half of that invested in the Wireless business. And free cash flow before dividends was $15.1 billion, a 22% increase from a year ago, a record performance for us, and dividend payments totaled $7.7 billion. With our strong year-to-date results, we now expect free cash flow to come in at $18 billion or higher for the year.

In terms of uses of cash, total debt is down $7.5 billion over the past four quarters with a debt-to-capital ratio of 38.6% and a net debt to adjusted EBITDA ratio of 1.42% to. At the same time, we have aggressively pursued our authorized share buyback. In the third quarter, we repurchased more than 100 million shares, and we continue to buy back shares. Through the end of last week, we had repurchased 271 million shares of our initial 300 million-share authorization for about $9.4 billion.

When you look at both dividends and the stock buyback, we returned more than $17 billion to our shareholders. And as you may recall, our Board has authorized a second 300 million-share buyback in July. This demonstrates our commitment to prudently restructure our balance sheet, to return value to shareholders, and our confidence in our ability to continue to generate cash. Our record cash flow gives us the flexibility to invest in the business or to retire debt. Our balance sheet is sound. Our debt metrics are solid. And all the time, we're returning substantial value to our shareholders.

Before we get to your questions, I'd like to take a moment to update you on where we stand on guidance that we first gave you in January. The details are on Slide 18. In January, we laid out a solid growth plan and we are on track. Were growing revenues, expanding margins, and increasing earnings in line with those expectations. In Wireless, we are also on pace to improve Wireless service margins, and we're still targeting 40%. And increased postpaid ARPU is more than 2% for the year. In Wireline, we still expect stable Wireline margins even in this challenging economy. And thanks an outstanding performance of our U-verse team, we actually are ahead of our forecasts for consumer Wireline revenue.

We did expect this Wireline to return growth this year, but as we told you last quarter that recovery is taking longer than we anticipated. And as I just mentioned, we expect free cash flow to be $18 billion or higher. At the same time, capital expenditures for the year are now expected to come in slightly lower than previously thought, at the low end of the $19 billion to $20 billion range. That's thanks to our team being more efficient with our spending. They're doing more with less. And as Ralph told you, we are ahead of our LTE deployment schedule. So we're doing this while still meeting all our network build goals. We also have been buying back shares aggressively with available cash, while keeping our debt metrics solid. Bottom line, we're seeing a solid performance this year, even in a challenging economy.

Susan, that concludes our prepared remarks. I think we're ready for Q&A.

Susan Johnson

Thank you, John. Let me turn it back to the operator. John, I think we're now ready to take questions.

Question-and-Answer Session

Operator

(Operator Instructions) And first on the line is Simon Flannery with Morgan Stanley. Please go ahead.

Simon Flannery – Morgan Stanley

Okay. Thank you very much. Good morning. John, I wonder if you could just spend a couple of minutes just talking through the rationale behind the actions you are taking on improving the pension funding position and why you chose that solution versus, say, other solutions And then, Ralph, perhaps you could give us more color on the mobile share. What are you seeing in terms of changing behavior? Are people really starting to add more devices now such as tablets to their plans? And is the share decisions and the dilution, if any, sort of in line with expectations? Thanks.

John Stephens

Good morning, Simon, and thank you for your questions. With regard to the pension funding, quite frankly, it's a fairly direct collection of issues that we're trying to address. First and foremost, the company had made some commitments to our employees and retirees on pensions and we're going to make sure we live up to those. Secondly, we wanted to resolve the issue not a year in time, but far into the future. Third, if we would have put a large amount of cash into the plan, there would've been challenges with how the fiduciaries would've invested that and where to put it, and what better place to put it than our own Wireless business

So that was the backdrop of the idea. We've discussed this with representatives of the DoL and had positive conversations with them on the possibility. When you put it all together and you can, if you will, solve or resolve funding for many, many years to come in a very cash efficient manner and join your employees in a form of ownership in your best business, we believe it's a win for everybody.

I will tell you we were really thrilled by the comments of the CWA on their national office and their support for it. And as a sidebar, our response from our employees and our retiree base has been great. They've been thrilled by it. But those are the backdrops. It's financially efficient. It's cash efficient. But most importantly, it funds the commitments we've made to our employees and retirees for a long time to come. Ralph?

Ralph de la Vega

Thank you John. And Simon, the results from our mobile share plans are just fantastic. I am just thrilled with what we've seen early on. First of all, as we mentioned on the call, the take rate, 2 million in five weeks, is outstanding. The fact that a third or more of our sales are picking the 10 GB or higher plan says that the ARPU that we were expecting from these plants is actually higher than what we expected. So we don't anticipate these plans being dilutive. And in fact, this is yet to play out, but they could be accretive. And you're seeing ARPU, as we reported, reflect some of that.

In addition to that, I mentioned something that's also very unique is that we're seeing about 15% of subscribers move from unlimited to mobile share plans. I think that more customers we have on usage-based plans the better we are. So I'm just really thrilled. What it really does for our future, Simon, is as we head into the fourth quarter, we're going in with a nice pace of mobile share customers. And then we're making available what I think is the industry's best line up of tablets. They have the full lineup of Apple, the full lineup of Android, and then the exclusive launches for the Amazon Fire HD and for the Windows 8 tablets.

So I think that we're going to have a really nice quarter with significant additions of tablets as a result of our mobile share progress.

Simon Flannery – Morgan Stanley

Thank you.

Operator

Our next question is from John Hodulik with UBS. Please go ahead.

John Hodulik – UBS

Okay. Thanks, guys. Ralph, maybe a question for you on the Wireless side and the iPhone. Have you thus far into the quarter seen those supply constraints that you talked about that shifted the sales into the base from gross adds, has that changed at all, or do you have better visibility in terms of volumes into the holiday season? And have you seen that percentage that goes into the base versus into gross adds, has that started to shift? And then secondly, you listed a couple of drivers in terms of ARPU growth. The smartphone mix is one of them. You're above the guidance right now. Do you think this is rate that can accelerate from here, or is this how we can expect ARPU trends to continue through the next couple of quarters?

Ralph de la Vega

John, I think that what is happening with supplies of iPhones during the launch is what we typically have experienced. In these first few weeks after launch, there typically is a supply constraint. And then it usually eases up, and I don't expect this iPhone launch to be any different. We have seen what happens during an iPhone launch, there's a huge spike in orders, and then they slow down, and then they get more reasonable because of the process that we use. And we've seen already that happen.

So I feel very comfortable that we're in a position where we'll be able to add additional customers as supply becomes available. We actually have seen in days in which we have supply available reach 5,000 or 10,000 net adds in a day compared to days that we don't. So we see that the net additions are fluctuation of inventory more so than anything else and we're pretty confident like in other launches that, that inventory will become available and we're going to do even better in the fourth quarter.

In terms of the smartphone mix, I love what we have done. As we mentioned in the report, we have added 1.4 million smartphones in the quarter, which means we've actually converted customers as well, customers that were paying us feature phone revenues, and almost doubling their revenues to us as we add 1.4 million smartphones.

So I'm very pleased with the mix. As we reported, we sold over 6 million smartphones in the quarter, which is up 1.2 million over a year ago and up 900,000 over the past quarter. So I feel really good that we're improving the mix of smartphones, which is a platform for future growth. And which by the way, John, we look forward to our meeting with you on November 7 and talking to you beyond the current quarter and the current year how we're going to use that smartphone platform to grow a host of other services that will allow us to grow ARPU.

John Hodulik – UBS

Great. Thanks, guys.

Operator

Our next question is from Phil Cusick with JP Morgan. Please go ahead.

Phil Cusick – JP Morgan

Hi, guys. Thanks. So I guess two, one for Ralph. First of all, the voice device is flat, it is driven my iPhone. But there is essentially no growth in the Voice business today, or in the industry overall. How you think about this going forward? Are people looking for voice growth? Are we just looking at it the wrong way and really we should be focused on tablets for industry growth going forward? Or do you think there's a natural level of voice growth available in the industry?

And then for John, you're buying back stock at the quarter at an amazing pace, but you're buying it back at multi-year highs on the stock. Are there other potential things to do with this cash, whether that be sort of invested back in the business and try and drive the business a little faster even? Or is that just not really possible or are there potentially acquisitions out there over the next year that you might start thinking about alternative uses? Thanks.

John Stephens

If you would, let me answer first then I'll ask Ralph. First of all with regard to the stock buyback, I think one thing you have to take into account with regard to the process is, for example, the shares we bought earlier in the year, we've already saved $0.44 or $0.88 or $1.32 in dividends this year alone. Because of our dividend rate the cash that comes back to the company, comes and lowers the price issues very quickly. That's one point.

Two, we do a very disciplined approach at looking at our net present value of our cash flows out of our business and our business plans. We compare that to, quite frankly, what analysts and people think of the value of our stock. And then third, we compare it to our difference between our cash cost of debt and our cash cost of equity. It's a very disciplined process and we follow it closely in making all our decisions to buy back shares.

Third, we have great financial flexibility. I mean maybe it wasn't forthright, but our debt ratios have actually come down. We continue to have great capacity in our balance sheet as we've lowered our net debt to EBITDA to 1.4 and our debt to equities well below 40%. So we've been buying back the shares with, so to speak, cash that would be sitting on the balance sheet. But you can see with what we've done with the spectrum and so forth that there is no lack of our ability to buy or to invest in our business. Were putting close to $14 billion in CapEx in the first three quarters. We're investing in the business. Let me, I'm sorry, do you have a follow-up to that

Phil Cusick – JP Morgan

No. That's great.

John Stephens

And let me take the revenue question, though, too. And I understand the customer account issues and so forth, but I really want to make a point from simply a financial perspective, a finance guy's perspective. Revenue growth is 6.6%. Service revenue growth is 4.5%. ARPU growth at 2.4%, and when you take out the data-only devices, ARPU growth at 3%. What's not to like about a business in this economy that's growing revenue like that, especially when things like to churn are down And network build plans are ahead of schedule And your quality of your network is operating continues to improve at a rapid rate There's a lot of things to like here. And there's a lot of different metrics to look at.

I'll let Ralph kind of realign whatever I said, but it's really important from simply a finance perspective. Revenue growth in this environment at a 6% cliff is pretty impressive.

Ralph de la Vega

I'm glad that we keep our CFO happy. But actually it gets even better that what John told you because what I really love about what we're taking in terms of an approach to our business is we're taking this massive data growth and then we're building products and services on top of that. One of the best examples I can give you is our launch of Digitize that will happen next year. And it, again, leverages this huge smartphone database and adds services on top of it and not just data access, but services that differentiate us from the competition. So you're talking about connecting the home with service automation and security monitoring. We're talking about connecting your car with all kinds of entertainment services.

So I see this huge level of services that are over and above the basic access. And so I think that future growth is in data but also services that we're going to layer on top of that great smartphone platform...

John Stephens

And then that data growth is why it's so important that we've got almost 30 million of our customers on tier data plans. And then three-quarters of them are buying the higher priced plans. Keeping them happy and giving them the quality service they want.

Phil Cusick – JP Morgan

That's great. Thanks, guys.

Operator

Our next question is from Mike McCormack with Nomura Securities. Please go ahead.

Mike McCormack – Nomura Securities

Hi, guys. Thanks a lot. Maybe just this first question for Ralph, I know we're digging in a lot on ARPU and voice trends, but thinking about the ARPU reacceleration, you guys had the lowest voice ARPU decline on a percentage basis since second quarter 2011. I'm just trying to get a sense of what you're seeing. Are people not pricing down to the buckets now like they were over the past year or so? And is there also a connection potentially for just seeing less family plan pressures going forward? And then a second one for John, if I can, looking at the deferred taxes resulting from the pension change, how should we frame that looking at the share repo as we look into 2013? Thanks.

Ralph de la Vega

So, Mike, I think some of the things driving our pricing and the price moves we made almost a year ago where we increased our data pricing. And that is driving our revenue growth. But we're also seeing people sign up for more data. And the fact is, as you sell more smartphones or more tablets, people need more data.

And the fact that we have a base that I think is the largest base in the industry with usage-based data pricing means as usage goes up, we can see some of that lift also coming from additional ARPU. So not only do we feel good where we are, but I feel really good about where we're going, because you have to have that base of usage base in order to be able to monetize the data growth that we foresee in the future.

John Stephens

Mike, it's John. Specifically to Ralph's point, our team addressed the voice and texting issues last year. And we went to a free mobile-to-mobile plan last year. And we looked through the effects of that, took that head-on and aggressively faced it. We're seeing the benefits of those decisions and those strategies that our mobile team put in place paying off today in higher ARPU growth.

With regard to deferred taxes in the pension plan, the pension plan contributions as all pension plan contributions are going to be deductible. And they're going to provide tax benefits from that perspective. That was part of our decision-making. In the sense of lowering your cash taxes, you're going to strengthen your balance sheet. You're going to strengthen your cash flows.

And that will all be taken into account as we make these regular evaluations of our buyback strategy. So certainly it will be taken into account. I don't mean the climate will make a decision one way or the other, but it is an important piece of it. And quite frankly, in an environment where there is some hope that in the next few years corporate tax rates may come down, it's important to take advantage of deductions at this time. I hope I was responsive.

Mike McCormack – Nomura Securities

Yeah. That's great. Thanks, John. Thanks, Ralph.

Operator

And next we go to Michael Rollins with Citi Investment Research. Please go ahead.

Michael Rollins – Citi Investment Research

Hi. Thanks for taking the questions. A question for Ralph and question for John, first Ralph, if you could talk about the change in customer behavior with respect to device replacement, if you go back historically, it seems like the average for years was 24 months plus or minus for a replacement cycle for a device. And it seems like it's lengthening significantly here. I was wondering what your thought is on that. Is it just the change to upgrade fees or policies? Or is there something more profound happening where customers want to keep their devices for a longer period of time?

And then, John, just going back to the enterprise side, you mentioned about some of the uncertainty clouding business decisions, and I was wondering what effect that has on pricing? Do you see some of your competitors trying to get more aggressive on pricing to force a decision from the customers in these RFP processes that you're going through? Thanks.

Ralph de la Vega

Mike, this is Ralph. Let me address the issue on what we're seeing with customer upgrade cycles. First of all, I think some of the policy changes that we put in definitely have impacted some of that behavior. And our approach is to give the customer a choice. If they want to get in earlier upgrade, they can do so by paying us an appropriate amount.

But we also have done some research, Mike, that addresses that issue of, it's just customer behavior in general changing, and we're seeing a slight change. We do see some customers that don't want to go through the upgrade process. And they're very happy with their devices. It's a smaller number than you would think, but we're beginning to see a trend with some customers that they're just as happy to keep the devices. If you look at some of the latest changes maybe they don't perceive them as being so significant that they need to upgrade and go through that process. So, we're seeing a slight change with a small number of customers that are holding onto the devices longer. And they're real happy. They're not churning. They're staying with us, and that is also fine with us.

John Stephens

Mike, with regard to the enterprise side, on the competitive landscape and the uncertainty. Quite frankly, in individual contract and proposal situations, we may see some unique or unusual pricing, but across the board, we're not seeing that. We're seeing the decision-making process not being driven by the pricing aspect, but more being driven by this uncertainty. And so we have generally seen a rational, what I'll describe as a rational pricing environment. I won't tell you that it's 100%. It will never be that. There will always be unique situations, but generally speaking, rational and the lack of buying decisions are based on the customers' uncertainty of the environment.

Michael Rollins – Citi Investment Research

Thanks very much.

Operator

Our next question is from Timothy Horan with Oppenheimer. Please go ahead.

Tim Horan – Oppenheimer

Thanks, guys. I'm just following up on that, Ralph, to the specific subsidies for device, how do you see that kind of trending out in the next few years, and I guess particularly with the Android? It looks like it's catching up to the iPhone a little bit. Can you see those subsidies come down? And maybe just on that point, is there any way really to reduce the subsidies on the iPhone?

And then, John, would you be willing to go above the 1.5 times debt-to-EBITDA? It seems really conservative in this environment. Thanks.

Ralph de la Vega

Tim, we work every day to look for devices that cost less and carry less subsidy. And we're definitely seeing some very nice devices these days that have all the features that customers want with less subsidy than we have seen actually in prior years. So we like the lineup that we have with Lumia devices coming in from Nokia. They are very nice devices, and they fit that same mold. So I see more and more devices coming to market that gives us the opportunity to continue to work on subsidies, which is something that is at the top of mine.

But the way we want to do it, is to have a great device that customers love, that carry less subsidy for us. We're not trying to scrimp on what we give the customer. So I feel very good that there's going to be opportunities to drive that down in the future as result of this great technology that we're seeing where the devices have great technology and they're actually cheaper to make. And so we can pass some of those savings on to the consumer. And some of them we can use to actually reduce our subsidies.

John Stephens

Tim, with regard to the 1.5 times debt-to-EBITDA, quite frankly, we're still operating in that environment and with that as a policy guideline. But with regards specifically to your question, I think you're right on, I think it's a very reasonable question to ask. Let me give you these insights. One is, we've been very aggressively refinancing our data as quickly as we can. We've called and refinanced over $8 billion worth of debt this year alone. So our average interest costs are coming down. You saw that in the third-quarter results. And even in the third quarter interest expense results we included some call premiums are included in the interest expense line or would've even been more favorable.

So the interest-rate we're paying comes down, which implies that there should be some flexibility with that net debt-to-EBITDA ratio. The reality of it is, at this point in time, our cash flows have been so strong that they have allowed us to buy back all the shares we've decided to buy back with existing cash, while not only holding but quite frankly, improving debt-to-EBITDA. But very directly, we actively look at it. We actively look at it, not just from the traditional debt ratios standards, but also from the cost of interest and how that might affect our ability to establish debt ratios. And we'll continue to evaluate that. Right now we're staying with our policy.

Tim Horan – Oppenheimer

Thanks.

Operator

Our next question is from Jason Armstrong with Goldman Sachs. Please go ahead.

Jason Armstrong – Goldman Sachs

Great. Thanks. Good morning. A couple of questions, maybe first for John, just on cash flow the extra sort of $2 billion plus, and maybe you can help us think through granularity on the bridge to get there between sort of better operating profit level versus lower cash taxes, lower CapEx, et cetera? And then the second question is for Ralph. I think one of the most interesting stats in the release as you pointed to is that a third of mobile share subs taking 10 gigs or higher.

When you look at that compared to wired broadband averages, which are sort of in that range, does this cause you to think differently about how these products compete with Wired? And maybe as an extension, as you guys look to review rural lines and prospects for sales divestitures or upgrading, if you're seeing this type of acceptance on Wireless data, can this be an effective solution for home broadband maybe in rural territories? Thanks.

John Stephens

So, Jason, let me take the cash flow question on. We're at 15 to 16 and we're now at 18 or higher. So we're raising our guidance $2 billion to $3 billion. If you want to look at where the pieces of that come from, certainly a piece of it comes from the fact that our network and our capital build guys are really being efficient with capital. They're getting all their jobs done. In fact, they're getting more ahead of plan, but they're doing it was less. Our pricing unit costs are better. Our cycle times are better, just a whole lot of activity there. So a piece of that is going to come from certainly that, and we're real pleased with that because I want to keep focused on they're ahead of schedule with their build targets.

Secondly, we're putting a lot of emphasis on working capital management across the company. We certainly have a lot of experience on the tax side, and we've done that in that area and continue to do that, but we're also doing it on management of receivables and prepaid expenses. Ralph's team has done a great job of managing inventory. We continue to manage our payables process.

And when you're a company as large as us, where you commonly have $15 billion or so of receivables or $10 billion worth of payables, you can work effectively with your partners, with your customers with your vendors to really improve working capital. That's where a lot of the improvement is coming from. And we believe we cannot only maintain that going forward, but I'm optimistic that we can continue to improve upon it.

Ralph de la Vega

And Jason, concerning the performance of our data plans and LTE in general compared to wired broadband, I am thrilled, first of all, with the performance of our network. We said it was averaging 5 to 12 Mb per second. But, quite frankly, it's much higher in some markets. We are just being conservative on what to say, but when you compare it to even Wi-Fi in some cases, it's even faster. So it is performing in an incredible, incredible way. And then to answer that, the response that we have seen in mobile share, say absolutely that I think there is a place where in some rural areas where I see the outline, that it could serve as an alternative to wired broadband.

Certainly in terms of speed and reliability and flexibility, it is absolutely very, very possible. And were going to be talking to you about that on November 7, giving you more details about our thinking of how we can use this technology. And, quite frankly, the customer reception to the technology in terms of their willingness to pay for great quality data in large, large amounts on November 7 when we meet with you and give you more guidance on our future growth plans.

Jason Armstrong – Goldman Sachs

Okay. That's helpful. Thank you.

Operator

Our next question is from David Barden with Bank of America. Please go ahead.

David Barden – Bank of America

Hey, guys. Thanks for taking my question. Ralph, maybe two questions for you, if I could, first is one of the things that has really helped this sector and I think people get very comfortable with these stocks, has been the kind of fairly rational read improving price environment that the sectors enjoyed for the last year or so.

But as we've pointed out here today, there is a slowness in the postpaid industry. Your net adds this quarter were 10% of what Verizon's net adds were. And I'd like to get a sense as to kind of how you feel about that situation and what levers exist for AT&T to pull to move that more in your favor as opposed to letting Verizon kind of get all the industry growth that's out there to be gotten?

And then second, obviously, looking down market things are changing quite a bit with the T-Mobile PCS deal and soft bank trying to put $20 billion to work in the industry. Is there anything about these lower-end competitors trying to shore up their financial resources and their scale that makes you think differently about the next year or two about how AT&T's behavior in terms of pricing and competition might be changing? Thanks a lot.

Ralph de la Vega

Let me first address the pricing rationale. And I think I'm very comfortable with the pricing that we've put in place. I think it's very competitive, and I think these mobile share plans are very compelling to customers. And I think those that don't put them in, in the industry will probably have to rethink down the road because I think the reception has been exceptional.

We mentioned that this quarter was a bit unique for us, Dave, in that we had 10 days of an iPhone launch and in those first 10 days what we see is a preponderance of iPhone customers, existing iPhone customers, which happen to be the best customers we have, the most loyal, with the highest ARPU, sign up in record numbers and use up the available inventory. I think that's actually a good sign, because it says that our customer base is loyal to AT&T and staying loyal to AT&T and it's actually reflected in the postpaid churn numbers, which are the best postpaid churn numbers for any third quarter in the company's history.

So if you're trying to grow customers, the first thing you got to do is retain your base and we're doing that. When we get additional inventory and when we go into the fourth quarter with a great lineup of tablets and our mobile share base, I am very certain that we're going to improve our performance compared to we were in the third quarter, in terms of net customer additions. But what I love about the strategy we have, Dave, is that we're not reliant on connecting more people or playing the traditional postpaid net adds game.

What we're going to talk to you on November 7 is that we're planning to grow the business by layering services, like Digitize, on top of this great base of customers that we have.

Those services are not dependent on adding more customers per se, but connecting more houses, connecting more cars and connecting more things that drive significant revenue streams with good margins for us and in a position which I think we hold the lead in the industry in, and that's what we'll share with you on November 7. So this is what I see in our future and I feel very confident about that. In terms of what we see happening with others in the industry, I don't think anything we have seen changes are plan. We're going to execute our plan and we're going to let others react to our plan, instead of us reacting to them.

But I feel very comfortable that we have the right strategy, both short term and long term, to continue to grow this business. And I tell you, I'm just thrilled that the network is performing as well as it is. We're seeing great reception to our LTE services and data plans. We're driving, if you look at our postpaid churn, significant improvement in postpaid churn, the best we've ever had. You look at ARPU, my gosh, the service ARPU being, in terms of our ARPU growth, the best in six quarters, postpaid ARPU growth. That says that the strategy that we're driving is the right strategy and we're going to continue to drive that. And if you look at John Stephens, he's really happy with the cash flow we're delivering. So I think it all bodes well for us.

John Stephens

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

Operator

And that'll be from the line of Brett Feldman with Deutsche Bank. Please go ahead.

Brett Feldman – Deutsche Bank

Thanks for taking the question. You talked a little bit about some of the reasons why your capital spending's running a bit lower this year. I'm wondering whether the capital efficiency of the LTE network is a part of that. Or if it's just too early? And then, could you just remind us what's involved in your initial LTE upgrade? If I remember this correctly, you're touching a fairly significant number of your cell sites as part of this initial build-out process. The reason I'm asking, is I'm wondering if when you get to the tail end of this late next year, you might be set up to see your CapEx in Wireless move down a notch?

John Stephens

So, Brett, let me take a shot at it and I'll ask Ralph to make sure we give you clarity with regard to the specifics of the network build. First and foremost, we are seeing efficiencies throughout our CapEx program from our procurement efforts, our price per unit efforts are a One AT&T cost initiative which we call our should costing process. What we're seeing is across all network programs, but because LTE is such a large piece of the network spend this year, we are seeing it there.

Secondly, with some prudent planning, both from our marketing sales guys on the demand aspect and our network guys on supply aspect of a quality network, we've been able to be really efficient with capacity that we're building in our 3G and 4G network, as opposed to new capacity we're building on LTE. And that's worked quite well. I'd expect us to be able to continue to provide efficiency in this, I think they've done great work, but I think there's more to come. I think it'll get better.

With regard to our LTE build, I believe we've publicly stated we're touching 90% of the cell sites in any market that we convert to LTE. So we're doing a, what I would consider a rather dense, a rather complete conversion. We're not doing what some other companies are doing with regard to a more scarce build-out. I think that goes to the quality of speeds that Ralph talked about, where they are far in excess of the 5 MB to 12 MB speed that we had talked about previously.

Ralph de la Vega

Brett, I just wanted to add to what John has said, that our network team has done a fantastic job of building out great coverage, with great reliability, at a really low cost. In addition to that, the products and services that are rolling out are some of the best that we have seen. The iPhone 5, for example, has some of the lowest drop call rates in this network environment that we have seen of almost any phone.

So we think as we move customers to our LTE network, it improves their service, it gives them great data, it actually improves the voice performance and at the same time, it relieves our HSPA plus network and the HSPA plus network gets better and we think that churn will be lower. So I'm very, very bullish on what this is going to do and we're just getting started with the new products and services you're going to see from us on the great LTE network that our team is building.

Susan Johnson

Thanks, Brett. As we close, I want to thank you for being with us this morning. We had a solid quarter, which gives strong momentum as we finish our year. That includes strong actual data growth in both Wireless and Wireline, solid earnings and record breaking cash flow and free cash flow results. Don't forget, our next webcast will be a video webcast of our Analyst Conference on November 7. I hope you can join us then, as we discuss the strategic direction of our company. Thank you again, for being on the call and thanks, as always, for your interest in AT&T. Have a good day.