Operator

Ladies and gentlemen, thank you for standing by and welcome to the AT&T first quarter 2015 earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions will be given at that time.

At this time, I'll turn the conference over to your host, Senior Vice President of Investor Relations for AT&T, Mr. Mike Viola. Please go ahead, sir.

Michael J. Viola - Senior Vice President of Corporate Finance, AT&T, Inc.

Okay, thanks, Tony, and good afternoon, everyone. Welcome to our first quarter conference call. Thanks for joining us. Joining on the call today is John Stephens, AT&T's Chief Financial Officer. John will provide an update with perspective on the quarter, and then we'll follow that was Qs and As.

One reminder, our earnings material is available on the Investor Relations page of AT&T's website, and that's att.com/investor.relations.

Before we begin, I need to call your attention to our Safe Harbor statement. The Safe Harbor statement says that some of our comments today may be forward looking. As such, they're subject to risks, uncertainties. Results may differ materially, and additional information is available on the Investor Relations page of AT&T's website.

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

John J. Stephens - Chief Financial Officer & Senior Executive VP

Thanks, Mike, and hello, everyone. Thank you for joining us today and thank you for your interest in AT&T.

We are very excited about the progress we've seen in our business the last three years. We set some ambitious goals to transform our business, every part of our business, to lay a new foundation for the future and for growth. The first quarter was another significant step in that transformation. To put it simply, we are executing very well. We have completed or are near completion with all of our Project VIP network initiatives. We are also ahead of plans with many of the transformational customer and operational initiatives that we now have underway.

The results are impressive. You know the story. Our 4G LTE network now covers 308 million people with ultrafast speeds. We also deployed new spectrum, densified the network, and added DAS [Distributed Antenna Systems] and Wi-Fi capabilities to improve the quality and reach of our best-in-class network.

Our expanded wireline IP broadband footprint reaches 57 million customer locations, and we now are offering 75-megabit speeds in 90 cities. We've also deployed fiber to nearly 800,000 additional business locations, with our 1 million goal in sight, enabling strategic services growth and network-on-demand possibilities.

While transforming these networks, we've also invested heavily to transition our customer base. Many of those transitions are nearing completion as well. Several years ago, we started to move our postpaid base to smartphones and usage-based pricing. Today, 84% of our postpaid phone base use smartphones, and almost 90% are on usage-based plans. And just one year ago, we accelerated the shift to the no-device subsidy model for smartphones when we launched Mobile Share value plans.

Customer response to these plans has been tremendous. About 60% of our postpaid smartphone subscribers already are on no-device subsidy plans. The surge of customers coming to value plans provides for some expected tough comparisons when looking at year-over-year financial results, but our record-breaking churn demonstrates that we made the right move in introducing these plans.

We also moved to strengthen our position in new growth areas. In prepaid, we acquired Cricket and paired it with our LTE network to provide a premium prepaid experience. We also saw the future of the Internet of Things and developed platforms such as the connected car and home automation. We now have more than 20 million connected devices on our network, and the future is very bright for additional growth.

In wireline, the transformation to IP broadband is nearing completion. That means most of the costs associated with this transformation are also behind us. Today, nearly 80% of our broadband base is on IP, and about 90% of the customers with access to IP broadband already have it. And more than 30% of our business wireline revenues come from our strategic IP services.

And finally, we have been laser focused on improving our operations, driving efficiencies across the board. We're seeing good traction with several Project Agile cost savings initiatives, including Digital First, which is our company-wide effort to make it easy for customers to do business online. The number of digital transactions with our customers has increased by the tens of millions the last two years, and we expect to see that increase by millions more in this coming year.

We also have been reducing cycle times in provisioning new services. This improves our competitiveness, our revenue opportunities, and the customer experience, while reducing expenses as well. And we took a giant step with our leading software-defined network initiative when we launched Network on Demand capabilities for business customers in 100 cities.

We continue to take steps to make our capital structure more efficient, including monetization of assets, reducing borrowing costs, and implementing working capital improvements. This has contributed to our strong balance sheet and gives us the financial strength we need to continue to invest and diversify our business.

The moves to diversify our business also continue on track in the first quarter. Those details are on slide four. We've executed Project VIP in our transformation well, doing the hard work necessary to enable the company to move forward. This puts us in a great position to achieve the vision we laid out for you last quarter, vision of a new AT&T, a diversified, integrated wireless and wireline company for both business and consumers, uniquely positioned in a world of high-speed mobile connectivity and video.

We expect the DIRECTV transaction will close this quarter. We have done a lot of work identifying opportunities for additional cost synergies between these two great companies. This includes savings from supply chain, installation, customer care, and even sending just one bill. This has increased our confidence that we can significantly exceed the original $1.6 billion expected in cost synergies. In fact, we now believe cost synergies alone will exceed a $2.5 billion run rate by year three.

In wireless, we closed on Iusacell, the first of our Mexico wireless acquisitions, and we expect to close the Nextel Mexico deal shortly. Together, these properties will give us a leading spectrum position in a dynamic wireless market that is just beginning its transformation to the mobile Internet. We plan to deploy a near-nationwide 4G LTE network, something we know how to do very well. It will be covering about 100 million people in a country that borders the United States. The cross-border opportunities that this opens up are exciting from both a consumer and a business standpoint.

We have also significantly improved our spectrum position here in the United States. Our Leap acquisition brought with it an average of 10 MHz of spectrum in the top 100 markets, covering 137 million people. Some of it was unused spectrum. We've already put much of that unused spectrum to work in more than 200 markets, and we've begun shutting down the legacy CDMA networks. We expect that process to be complete by the end of the year, and we will quickly redeploy that spectrum as well.

We also made a major investment earlier this year when we acquired licenses for near-nationwide contiguous 10x10 MHz block of high-quality AWS-3 spectrum. Needless to say, we feel good about our spectrum position. This takes a lot of uncertainty out of the process with our ability to add capacity and maintain quality in a cost efficient manner. We know what we have and we know what we need to do, and we have a clear path to delivering a network that customers want, that customers expect, and that customers will use.

With that as background, let's take a look at our consolidated financial summary on slide five. Adjusted consolidated revenues grew to more than $32.6 billion. That's up about $375 million when you adjust for the sale of our Connecticut wireline properties. This growth was driven by continued success in wireless as we reposition our business model, strong demand for strategic business services, and adjusted wireline consumer revenue growth. Adjusted wireline revenues were down about 1%, but revenues were essentially flat year over year if you adjust for the impact of foreign exchange and discontinued businesses.

Adjusted EPS for the quarter was $0.63. That includes adjustments for Leap integration expenses as well as costs associated with the voluntary employee retirement plan. It also excludes a one-time $0.05 benefit from a tax planning related matter. And while we don't show this on an adjusted basis, first quarter 2014 earnings also include the income we received from our previous equity ownership of América Móvil as well as net income from our domestic Connecticut wireline operations. Those two provided about $0.03 of EPS in the first quarter of last year that we don't have this year.

Our business also continues to generate solid cash flows, with free cash flow of $2.8 billion. Cash from operations totaled $6.7 billion, and that includes an additional $500 million investment in our Next customer base. And capital expenditures were $4 billion. At the end of the quarter, our cash balance was $4.4 billion. And in terms of uses of cash, dividend payouts totaled $2.4 billion.

At the same time, we maintained a solid balance sheet while continuing to invest in the business. During the quarter, we funded investments in AWS spectrum and Iusacell. And we are also well positioned for our planned investments in DIRECTV and Nextel Mexico.

Net debt to adjusted EBITDA at the end of the quarter was 2.19 times. And as we've said before, with our transformational investments in DIRECTV, Mexico, and spectrum, we will go above our normal net debt to EBITDA target. But after we close the DIRECTV transaction, our focus with free cash flow after dividends will be on paying down debt and getting back to our target range.

Now let's turn to our operational highlights, starting with wireless on slide six. Our wireless results this quarter only include our domestic operations. Information on our Iusacell operations is included under the international segment in our financial statements and is separately broken out.

The repositioning of our smartphone base by giving customers the choice of lower-priced service with no device subsidy plans continues to show positive results. Postpaid churn was 1.02%, the best first quarter that we have ever had and the best in the industry this quarter. This continues the positive trend we saw last year and comes in a very noisy and competitive marketplace. And prepaid churn also showed strong continued signs of improvement thanks to the strength of our Cricket operations.

Total net adds came in strong at 1.2 million. That was led by gains in postpaid and connected devices. We added more than 440,000 postpaid subscribers in what is traditionally a slow net add quarter, thanks to strength in tablets. These tablet gains more than offset a decline of feature phone subscribers. We also grew our high-quality postpaid smartphone base by another 500,000 in the quarter. This includes postpaid upgrades and migrations, which we don't include in our net add number. And when you look at total branded smartphones, which includes both postpaid and prepaid, we added about 1.2 million smartphones to our base during the quarter.

We also added about 1 million connected devices, thanks to a continued strong showing by connected cars. Connected device net adds were impacted by a change in how we report our session-based tablets. Previously, we included them as part of our prepaid base. Now they're reported as connected devices subscribers. This gives us and you a better view of phone growth in prepaid, which now essentially includes only phone activity. You see that this quarter.

Thanks to strong results from our Cricket offering, we had positive growth in prepaid. Cricket is just the latest example of our ability to integrate new businesses. The team has done a very good job of transforming this business. Retention is ahead of schedule. Churn is less than expected and certainly much less than historical levels prior to our ownership. And we're doing a great job of moving customers off the legacy CDMA network. More than 90% of Cricket customers already are on the GSM platform. However, we do expect to see some pressure over the next quarters as we complete the transition to GSM and shut down the legacy CDMA networks.

Overall, postpaid gross adds and upgrades continue at a solid pace. We had about 6.2 million smartphone sales in the quarter, slightly higher than last year's total. Our postpaid upgrade rate was 6.6%. Smartphones were 94% of all phone sales, and now make up about 84% of our postpaid phone base. We still have about 16% of our phone base to transition to smartphones, but the bulk of the smartphone transformation has been completed. Transforming our phone base to LTE smartphones and moving those customers to no-subsidy and usage-based pricing has been a big investment for us. But once again, we made these investments, executed our plan, and are now in a strong position to move forward.

Now let's look at the progress we're making with shifting our customers to AT&T Next and Mobile Share. That information and revenue are on slide seven. AT&T Next sales reached record levels, nearly two-thirds of smartphone sales. Another 5% brought their own devices to our network. That means 70% of phone sales in the quarter didn't carry a subsidy. Total wireless revenue was up about 2%, driven by 36% growth in equipment revenue. The customers who choose to bring their own devices don't increase equipment expense for us, so the no-device subsidy model works for our customers and us, whether it's with Next or with bring your own device.

As expected, service revenues this quarter were impacted by Mobile Share value plans. But because we have now passed the anniversary of the introduction of these plans, we expect the year-over-year comparisons will improve in the coming quarters. At the end of the first quarter, more than 70% of our postpaid base is on Mobile Share plans, with more than 60% of the postpaid smartphone base on no-device subsidy pricing. This means our first quarter Next flow share percentage has exceeded the percentage of smartphone subs on no-device subsidy pricing. Mobile Share customers continue to buy up to larger buckets of data. About half of all accounts are on plans 10-gigabytes or larger and about 20% are on plans of 15-gigs or more. That's more than twice as many as a year ago. This helped drive a 14% increase in data billings.

As expected, the strong Next take rate helped drive the third consecutive quarter of sequential phone ARPU growth when you factor in Next billings. The metric gives you a more accurate idea of what an average customer pays us each month. Phone-only ARPU with Next was more than $66 in the quarter, with the average monthly Next billings about $6 and growing. That strong sequential increase comes even when you factor in the impact of our new Data Rollover plan, which generated about $0.25 of ARPU pressure in the quarter. As the Next base grows, so does the impact on billings. More than 30% of our smartphone base is now on AT&T Next, but 65% of our sales are on Next, so our ARPU with Next is expected to continue to grow.

Now let's move to our wireline operations on slide eight. Our focus on profitability and transforming to IP technologies can be seen in our wireline results. On the business side, Strategic Business Services are now close to a third of the business wireline revenues, and we continue to see strong demand for those services. Adjusted Strategic Business Services revenues grew by more than 15% in the quarter. And when you adjust for FX, growth was more than 17%. Adjusted wireline business revenues were down 3.3%. However, about half of that decline comes from the impact of FX and our discontinued low-margin businesses, such as Global Hubbing. If you consider those items, the decline would have been 1.7%.

And if you look at our combined business wireline and wireless operations, revenue actually increased year over year. While overall wireline business operations saw pressure, it was most pronounced in wholesale, in part due to our focus on profitable sales and the continued impacts of network grooming. Enterprise revenue was down less than 1% when you adjust for Connecticut and FX. Small business revenues were also down. However, there are some positive signs with new business starts and growing sales from our fiber build.

We also took a significant step recently in our transition to software-defined networks. We introduced Network on Demand for business customers in more than 100 cities. This allows businesses to easily order, add, or change network services on their own in real time.

In consumer, U-verse services now make up about 70% of consumer revenues and helped drive adjusted consumer revenue growth of more than 2%. U-verse started the year with solid subscriber gains, increasing penetration, and strong revenue growth, including adding more than 400,000 IP broadband subscribers. That helped drive a net gain of almost 70,000 new subscribers to our overall broadband base.

We are nearing the completion of our broadband conversion to IP. About 80% of our broadband base is now on IP. That's 90% of our IP-eligible customers. So we expect the number of migrations to ease throughout the year as well as the costs associated with those conversions.

At the same time, we continue to increase broadband speeds. We expanded our 75-megabit services to nearly 90 cities, and we offer GigaPower in 10 markets, including a just announced deployment in Chicago. We also hit a milestone with our Voice-over-IP services in the quarter. We now have more than 5 million VoIP subscribers. All this helped drive an increase in adjusted U-verse consumer revenues of almost 20%.

Now let's move to margins, starting with wireless margins on slide nine. Wireless service margins were essentially stable year over year. There was pressure from customers on no-device subsidy pricing in advance of upgrades and from the full quarter of inclusion of Cricket operations. And our new Data Rollover plan also had about a 20 basis point impact on margins. This was offset by the impact of AT&T Next and cost saving initiatives in the quarter.

Wireline margins continue to stabilize, and operating margins were flat year over year. There was pressure from non-cash benefit expenses and TV content costs, but this was offset by growth in consumer and Strategic Business Service revenues and solid execution on our cost initiatives.

For the quarter, our adjusted consolidated operating margin was 18.5% compared to 19.6% in the year-ago quarter and 18.9% two years ago, but most of the year-over-year difference is due to our strategic investments in Mexico and Cricket.

Cost efficiencies continue to be a priority with us. We discussed the success of our Digital First initiative earlier. We also have made headway in cutting cycle times to provision new business services. We're seeing up to a 40% reduction in cycle times on some IP products, with more than a 50% reduction in the fiber-ready buildings. Our software-defined network initiatives will help even more.

Before we open up the call for your questions, let me do a quick recap of the quarter on slide 10. The first quarter was another big step in the transformation and diversification of our company. Customers are moving to Mobile Share value plans and AT&T Next in increasing numbers. This helped drive industry-leading postpaid churn and more than 1.2 million wireless net adds.

The success of the migration to IP technologies can clearly be seen in our wireline revenue numbers. IP services now make up 70% of our consumer revenues, and our migration to IP broadband is near complete. In business, Strategic Business Services, which include our IP services, is close to a third of the wireline business revenues. Strong demand has revenue growing at more than 15%.

At the same time, the moves we are making to diversify our business through video and international operations are on track. We are confident the DIRECTV and Nextel Mexico deals will close this quarter, and we are taking steps to get all plans in place to close these transactions quickly.

Our solid balance sheet and cash flows provide the financial strength to invest and to make these transformative moves. We feel very confident with our standalone guidance for the year. We're on track and on plan. In fact, we're actually ahead of plan in many of the areas, including free cash flow. That gives us even greater confidence that we can hit our growth targets for the year while also being prepared for the DIRECTV and Nextel Mexico acquisitions.

We are on the starting blocks for a very exciting year for AT&T. We have made the investments and done the hard work necessary to position us to be a very different company, and we are ready for the opportunity ahead of us.

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

Question-and-Answer Session

Operator

Thank you very much. Our first question will come from Simon Flannery with Morgan Stanley. Please go ahead.

Simon Flannery - Morgan Stanley & Co. LLC

Okay, thanks very much. John, thanks for the update on DIRECTV. Can you just go into the merger synergy guidance a little bit more? Just what are the main buckets there? And help us think about how it phases year one, year two, year three. And then you sound confident on the closing this quarter. Given all of the headlines we have out there, just can you just give us some more sense of what makes you so confident? Thanks.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Thank you, Simon. Real quickly, Simon, the base of most of our savings that we previously announced was going to content contracts as we understood them to be standard in the industry. And that was the basis for a large part of our $1.6 billion original target; that along with some of the normal synergies associated with bringing two public companies together.

The additional ones are the opportunities we now see in going to, for example, one single truck roll to install products, so combining the installation of both our broadband capabilities and our video capabilities into one truck roll; or getting the customers on one single bill, one single customer care operation; the ability to go to our supply chain to get better pricing with regard to our equipment because specifically one of us was buying set-top boxes and other equipment at lower numbers than the other one was. And so when you combine those, we're confident we can get some more supply chain savings.

There's also the standard cost of things like combined advertising, combined customer care, combined activities. But that's what we built up to this $2.5 billion. They are cost savings. But we believe that they are very much real, very achievable, and we believe that they'll grow. Certainly in that third year is when they get to that $2.5 billion level, but they are significant during the 2017 third-year timeframe. They will build starting in 2015 but build really in 2016 and really move toward significant amounts in 2017.

With regard to our confidence in the transaction closing, it really comes down to what the transaction is about, and that is bringing customers greater choice, bringing more competition to the marketplace, bringing expanded opportunities for customers to get bundled services, services that they want, and really to improve the broadband capacity that's out there for customers through our additional investments of some of these savings. So as we continue to go through the process, we continue to feel good about where we're at, and we are optimistic and continue to believe we'll close it this quarter.

Simon Flannery - Morgan Stanley & Co. LLC

Great, thank you.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Thank you.

Operator

Thank you. The next question in queue will come from Phil Cusick with JPMorgan. Please go ahead.

Philip A. Cusick - JPMorgan Securities LLC

Hi, John. Thanks. A quick follow up on Simon's question. Have you had any indication from the DOJ or FCC either way in terms of approval?

And then second, if you can talk about the Mexican business, the same thing. What barriers remain to closing Nextel? And how do you think about integrating those businesses from here and the need to ramp up CapEx to do that? Thanks.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Yeah. So as would be normal in a transaction like the merger of DTV and AT&T, our legal representatives are having the normal process and contacts with parties within the rules in the normal course. I won't go into those details. But I will tell you, Phil, if you look at what's on the record out there and the benefits this brings, I think there's an easy path to see why this deal would get approved and the benefits it will bring to consumers. So I'll leave it at that. We continue to feel good about it.

With regard to Mexico, the process for Nextel first had to go through the U.S. bankruptcy process and the opportunity for other bidders to come in. That process has all been completed. The U.S. bankruptcy court has approved the sale. So we're now just left with getting the regulatory authorities in Mexico, IFETEL, to approve it. We're in, as you might expect, normal contact, and that would be normal in a deal, respectful contact and working through issues with them. Our experience with them on Iusacell, our experience with them on the regulatory framework that they've set up, and the economic environment they set up gives us confidence that that deal could close shortly.

Philip A. Cusick - JPMorgan Securities LLC

And in terms of integrating those two mobile businesses once you have them?

John J. Stephens - Chief Financial Officer & Senior Executive VP

Yeah. So we will operate as one business. We will get significant benefits from the two networks. And so we will be able to utilize the infrastructure of both companies to really help us manage and really prioritize capital investments, so it really will allow us on a combined basis to ramp up the networks much more quickly. As we mentioned in my prepared remarks, when you combine the two companies, they clearly have a leading spectrum position in Mexico, which also gives us an opportunity to very efficiently ramp up.

Your comment or question, Phil, with regard to will we need to spend capital on that asset, absolutely. We intend to get the network quality up to our standards. And as quickly as prudently possible, we're working through those plans. And once we get the Nextel Mexico merger completed, we'll have all the information at our disposal to finalize those plans, and then we'll come back to the Street at the same time we do with the DIRECTV merger and update you on those plans. But it will take some additional capital. But quite frankly, in the company the size that we will become once the DIRECTV and Nextel Mexico deal are closed, it will be a very manageable level of additional capital.

Philip A. Cusick - JPMorgan Securities LLC

Okay, thanks, John.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Thank you.

Operator

Thank you. Our next question in queue, that will come from Mike McCormack with Jefferies. Please go ahead.

Michael L. McCormack - Jefferies LLC

Hey, guys. Thanks. Hey, John.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Hey, Mike.

Michael L. McCormack - Jefferies LLC

Just a couple things. I guess first on the wireless side, I think your comment the way we would read it is that phone-only ARPU and service revenue from a year-over-year growth perspective, have we bottomed out and hit the tipping point there? And then secondly on wireless, what's the experience that you're having with customers that are on the Mobile Share value when they go to upgrade? Are you seeing any unusual churn activities around those guys?

John J. Stephens - Chief Financial Officer & Senior Executive VP

Mike, quite frankly, we're not seeing any unusual churn activities, really. I don't mean to be inappropriate, but the 1.02% postpaid churn is the best we've ever had. And if you go beyond, if you subdivide our postpaid base into postpaid smartphones, as you can imagine, the trend is even lower. So we feel very good about that.

With your comments with regard to service revenues, when you look at our service revenues this quarter, clearly it was impacted by, so to speak, a full year of opportunity for customers to transition to Mobile Share, and really not only about a month, no time prior to the first quarter of 2014 and only about a month of 2014 first quarter for customers to transition. So this is going to be the starkest comparison or the most significant comparison time. We expect those comparisons to get easier or to be less challenging as we go through the year because we've established much more of a stable Mobile Share value base as of the end of the first quarter compared to where we were at the end of the first quarter last year.

Michael L. McCormack - Jefferies LLC

John, if I can just sneak one in, just thinking about cash flow, any thoughts on plans for factoring in 2015, a magnitude question? And CapEx run rate a little lower than we anticipated, is that just ahead of the deals closing?

John J. Stephens - Chief Financial Officer & Senior Executive VP

CapEx is just what we needed. It is lower than the run rate. We're not changing any guidance on CapEx. It's just more of a philosophy to spend it as you need it, don't spend it early.

With regard to factoring, you can expect us to factor every quarter this year. Part of that process is to get an established track record on that. We did do it in the quarter. Even with the factoring we did in the first quarter, we added to – as I mentioned in the prepared remarks, we added to our total investment in our Next customer base by about $500 million. But I think we expect to continue to use that securitization process in an effort to eventually get to a point where we'll have another option for financing our business, whether we choose to use it or not.

Michael L. McCormack - Jefferies LLC

Great, thanks, John.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Thank you.

Operator

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

John C. Hodulik - UBS Securities LLC

Okay, thanks. Hey, John, just a couple questions. First actually, can you give us a number of how much factoring was done in the quarter? And then a couple follow-ups to previous questions, the 70% of adds coming on no subsidized plans is a big number. Is that the top that we can expect, or can you push that still higher?

And then lastly, switching gears over to wireline, margins were off, EBITDA margins were off a little bit on a year-over-year basis. Can you give us a sense for maybe what's driving that and how that should trend on a year-over-year basis? Should we continue to see declines, or with some of the costs coming out of the Connecticut properties, do you expect that to be bottoming around here? Thanks.

John J. Stephens - Chief Financial Officer & Senior Executive VP

So, John, let me try to make sure I hit all these, and challenge me. If I skip one, let me know.

John C. Hodulik - UBS Securities LLC

Sure.

John J. Stephens - Chief Financial Officer & Senior Executive VP

First, I think we mentioned that we had about 65% take rate on Next on about 6.2 million net adds and upgrade sales, so around 4 million Next sales. You guys can do the math on an average price of a phone to get the gross receivable. We mentioned that we increased our receivables, net increase in our investment in our customers by about $500 million. The offset to the rest of the purchase price was about $1.5 billion of factoring, and then some collections from customers from previously sold Next phones in early 2014 or even a few that we sold and 2013 that are now paying us monthly fees that we are collecting and keeping at the company. So we're not subject to prior monetizations or securitizations.

On the net adds, at 70%, I think the key assumption there is we've seen this 60% – 65% Next take rate before and we've seen it again this quarter. The one thing I will tell you is that to get it to 70%, we had about 5% or about 300,000, a little over 300,000 BYOD devices. Those are great net adds for us. While they don't bring any equipment revenue, they don't bring any equipment expense. And so that's a good deal for us. They often join Mobile Share value plans, so they are sticky customers.

That is the unknown, if you will. That 300,000 is a little bit below what it was running on a quarterly basis the last three quarters of last year. But this is typically a slower – first quarter is typically a slower quarter. We're still encouraged by the level that – that will be the determinant of where we come out, whether we come out in that 60% to 65% range or if we get higher than that. We'll just have to wait and see. But I do feel very good about the fact that in total that no-device subsidy is at 70%. And quite frankly, the overall base on Mobile Share value for smartphones is at 62%, so we're running hotter than that.

And then third, the amount of those customers that are actually paying us monthly for Next today is down in the 32% range. So I'm very optimistic that the monthly Next ARPU piece, the monthly billings piece, is going to pick up from that $6 level.

John C. Hodulik - UBS Securities LLC

Right.

John J. Stephens - Chief Financial Officer & Senior Executive VP

EBITDA margins, we're going to continue to focus, particularly in wireline, on cost savings. I think you're aware that we did an early – voluntary early retirement program. I think our take rates on that were in the 3,300 range, so we'll see some savings from that going forward.

Additionally, we did see some pressure in the first quarter as we converted some of our former backhaul or interconnection in Connecticut from company-owned to leased arrangements. So they moved out of depreciation in some of those characteristics into COE. And we'll manage through that and manage the efficiencies of our operations. We'll overcome that during the year. So those are the things we're working on to improve those margins. And as I said, we're still confident with our guidance, and that guidance included improving margins in wireline, wireless, and overall.

John C. Hodulik - UBS Securities LLC

Okay, great. Thanks, John.

Operator

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

Brett J. Feldman - Goldman Sachs & Co.

Thanks. Just to follow up a bit on churn, if I listen to some of things you were saying, you've got a growing share of your base on Mobile Share value plans. And there's obviously a lot more value in those plans, so they're more attractive. You have a growing percentage of your base on smartphones, which you said have a lower churn profile. And you keep selling tablets, meaning your average customer probably has multiple devices, and usually that means lower churn. So is it reasonable to think you could actually continue to improve churn from here? I know the second quarter of last year is a tough comp, so putting that aside. Or are there mitigating factors, including the competitive environment, that might just create a little bit of a floor on where you can go right now?

John J. Stephens - Chief Financial Officer & Senior Executive VP

I'll say this. We're very pleased with where we came in on churn in the first quarter, particularly with the noisy and competitive environment that we operate in. But we are not getting into the fact that we can't do better from here on out. We're not predicting that. We're not guiding to that, but we're certainly striving to do that. You are right, Brett, that the second quarter of last year is going to be really tough comparison. But with that being said, we still are striving to do better each and every quarter than we did the last quarter, and we'll keep that effort up.

When you think about Mobile Share value accounts, there are just under about 20 million of those accounts, and they average just under three devices per account. I think we can get you the detailed numbers, but it's probably about 19.5 million accounts, and there are about 2.9 devices per account. And yes, that really does help with churn.

Additionally, our smartphone churn is lower than our total postpaid. Effectively, our feature phone churn is higher. And as we've reduced that base down to 16% now of our postpaid base and we're seeing flow share of only about 6%, we're optimistic that we can increase the smartphone base. And that will give us another lever to really make an attempt to manage churn to a lower level. With all that being said, it is a competitive environment, and we have to be ready to handle whatever situation issues, offers come out from other parties in this environment, regardless of the logic that may or may not be behind them.

Brett J. Feldman - Goldman Sachs & Co.

Great, and just as a quick follow-up, since you mentioned the feature phone base, as you come towards the tail end of migrating them to smartphones, how do you think about that residual base? Is there a proactive effort to get all of them into smartphones, or is there just an acknowledgment that some of those customers will probably eventually just come to end-of-life and you're going to let them go?

John J. Stephens - Chief Financial Officer & Senior Executive VP

We don't want to necessarily lose any customers, Brett, we want to keep, and we've got a lot of really good ones that are still on feature phones. But the issue is the functionality of our networks is so dramatically different when you're using a smartphone, and the value our customers can get out of our networks is so significant, is so much greater with a smartphone. So we're certainly encouraging that.

What I will tell you that's encouraging to us, though, is that we're finding that we're having real success in the prepaid space, in the traditional no-subsidy or low-subsidy model prepaid space and still getting really good ARPUs and still using a lot of maybe lower cost but a lot of smartphones there. We had a significant number of smartphones added to our prepaid base. So I would tell you that a feature phone that may not want to go to the full postpaid smartphone relationship might stay with us in a prepaid relationship and still get the benefits of some very good network and quality and phones, and yet do it in a different pricing in different subsidy mechanism.

Brett J. Feldman - Goldman Sachs & Co.

Great. Thank you for taking the question.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Sure.

Operator

Thank you. Our next question will come from Frank Louthan with Raymond James. Please go ahead.

Frank G. Louthan - Raymond James & Associates, Inc.

Great, thank you. Can you give us a little more color on what you said about seeing some increased signs of some improvement in SMB and passed homes with fiber, some additional businesses with the fiber build? How many additional businesses have you built? And what are some of the signs that you're seeing a little bit of a turn in that part of the business?

John J. Stephens - Chief Financial Officer & Senior Executive VP

So, Frank, we've built – 800,000 customer locations have been passed with fiber. What we did is we built a significant amount of those to customer order, where customers, existing customers, new customers order that and want us to build. But we also built a measurable amount to, if you will, into areas where we were confident we could sell and be effective. In those areas that we've built and spread the copper before we had a contract in place, we are now aggressively selling into those areas, and we have been pleased about the ability to penetrate those buildings and to sell into those. So that's the encouragement.

In many of those buildings, you've seen how it works. You can go into a building. It might have 20 potential customers in there, and you have to sell to the first one. And once you get the first one sold, you can come back and then have some credibility with selling to the second, the third one. So we are making some significant progress in getting those first sales inside the building. And the team is working hard under Ralph de la Vega's leadership to then go back and really maximize all the opportunities in those buildings. People love the fiber and the high-speed that it provides, the quality of that service. So this investment ahead of an order is starting to show signs of paying off. That's what's encouraging.

Additionally, we're continuing to see interest from our normal business, small business customers, and some of our packaged deals with regard to a combination of our bundled mobility and wired IP services. I don't want to suggest that we are seeing the small business market take off, but we are, and our numbers will explain the reason for me saying that. But we are seeing continued strong demand for IP and strategic based services, those Ethernet-based services, those IP-based services.

Frank G. Louthan - Raymond James & Associates, Inc.

And what should we expect going forward on a quarterly or annual basis for these types of businesses that pass? How many more do you have?

John J. Stephens - Chief Financial Officer & Senior Executive VP

We're going to get to 1 million business customer locations passed. If you think about the run rate we've been on, it's pretty easy to think that we can get to that 1 million by the end of the year. That would be a very reasonable process. We've publicly stated that we can get there by the end of the year or shortly thereafter. So that is what I think you can expect.

With regard to predicting growth rates or trends in the small business area, we haven't done that. But I will tell you on the overall Strategic Business Services, I am encouraged that we're at the 32% level of revenues. I'm very encouraged that it's reached $2.6 billion. I'm very encouraged that even in this tough environment it grew 15% on an adjusted basis. And when you take into account FX pressures, it would have grown 17%. I think the team is doing very well, and the network we built is attracting customers for its quality, its security, and its speed.

Frank G. Louthan - Raymond James & Associates, Inc.

Great. Thank you.

Operator

Thank you. Our next question will come from Amir Rozwadowski with Barclays. Please go ahead.

Amir Rozwadowski - Barclays Capital, Inc.

Thank you very much. Good afternoon, John and Mike.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Hi, Amir.

Michael J. Viola - Senior Vice President of Corporate Finance, AT&T, Inc.

Hi, Amir.

Amir Rozwadowski - Barclays Capital, Inc.

I just wanted to follow up on the questions around the competitive landscape. How do you think about the level of promotional activity for the course of this year versus last year? And specifically, how should we think about your strategy going forward? Last year, obviously, you made a concerted effort to adjust pricing in order to migrate more of your subscribers onto Next. Do you foresee needing to have to do that again? It doesn't seem like, based on the comments that you made on ARPU trajectory, but I just wanted to confirm.

And then I'd also be interested to hear your thoughts on the Google announcement today and whether you view it as a possible new competitor over the mid to longer term, even though it seems fairly limited in scope based on what they announced today.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Okay. I think with your first question, Amir, I think you'll continue to see us taking actions on the strategy that we have laid out already; that we are going to continue to focus on profitable customers and providing smartphone growth, Mobile Share value, getting customers on Next or BYOD, and continuing to migrate. Now we've got 90% migrated to usage-based plans, and use the LTE deployment of phones and the, so to speak, year-over-year growth, data growth we've seen of those phones of about 50% to then drive data growth and then drive higher buckets. So that's the strategy there.

Sure, I'm certain we will have some promotional activity, as we always do, but I wouldn't suggest to you that it would be out of the ordinary, out of the normal process. I will also suggest here that we are just in the beginning phases of the connected car, of the Internet of Things, and of the opportunities that that's going to provide us. This really deep, high-quality, 308 million people that are covered with LTE or have LTE available to them is really a great thing for all the Internet of Things product and services, whether they be the connected cars or the other platforms we have out there. And we believe that over terms, we'll see really great growth there. I think we added close to 700,000 connected cars in the quarter. So it still has a long way to go, but it's growing very quickly. And remember, what we're seeing today is really just mostly the wholesale arrangement, and here as we mature through this process, we'll get that opportunity to get the retail arrangement.

With regard to Google, I would suggest to you I'm not an expert on the matter, so I don't mean to be, but I understand your commentary about it's very limited. So I understand it's limited. It's got a very limited number of devices. That's not generally the way we like to present options to customers. We like to provide a lot. My understanding it's limited in this case. My understanding also is that there's going to be very limited distribution and customer care. And those things are items that we found our customers value. So we'll just have to wait and see, but it's just another one of the plays in the environment that's out there.

Amir Rozwadowski - Barclays Capital, Inc.

Great, thanks very much for the color.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Take care.

Operator

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

David W. Barden - Bank of America Merrill Lynch

Hey, guys. Thanks for taking the questions, maybe two if I could. Just the first one, Verizon is getting a lot of attention on the OTT strategy, both skinny bundles and the wireless side. But depending on how things shake out, AT&T could be the nation's largest video player. Could you give us a sense as to the timing and what we should be expecting coming from AT&T on this front? Are you working on this pro forma knowing that DTV deal is behind you, or do you have to wait for the DTV deal? I think people would love to know where you guys stand on that.

And then just second, I think, John, you've thrown out a deleveraging target at some of the conferences of about 1.8 times within a three-year timeframe post the deal. Could you divide – waterfall how you get there from a combination of operations and asset sales? And then rumor has it you're running the real estate group at AT&T now. Could you map out where the buckets for asset sales inside of AT&T are and scope it for us? It would be helpful. Thanks.

John J. Stephens - Chief Financial Officer & Senior Executive VP

So let me get to a couple things. One, I won't give any detailed plans about post-DTV AT&T. I don't think it would be prudent at this time. But what I will tell you is that over-the-top distribution of video on wireless, on broadband connections with or without linear subscription is something that I'm sure we'll see and something that we will see be a part of packages in the future. My own experience is that I see it as an add-on to a subscription package. And I think we believe that that will be the way a lot of the opportunities will go, but we're certainly open to it, and we're going to certainly be in a position to help and develop that part of the process. I won't go into the Verizon situation or any specific offers on our part.

With regard to deleveraging, I will go this way. We're expecting free cash flow to exceed dividends and provide cash not only this year but into the future to pay down debt. That's one. Two, we're expecting EBITDA to expand, not only just from the acquisition of DTV but from the content savings – excuse me, from the cost savings that we've talked about even today. And that will expand EBITDA even more, which will by simple math help the metrics of net debt to EBITDA. Third, we'll continue to look at all aspects of our asset portfolio. As I've mentioned before, we have a about a $300 billion total asset portfolio today that will only get larger with DTV and Nextel Mexico. And so we will continue to look for opportunities.

I would suggest to you that if you look at our record over the last three years, we have a pretty reliable record of generating over $15 billion worth of cash from asset monetizations, and we've done it very tax efficiently, so we've netted a significant amount of that cash to be able to use. And we'll just continue to do the same process that we've done. I wouldn't expect anyone to think that we are complete in that process, but I'm not going to get into listing any specific items.

David W. Barden - Bank of America Merrill Lynch

Got it. Thanks, John.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Sure. Thanks, David.

Operator

Thank you. The next question will come from Michael Rollins with Citigroup. Please go ahead.

Michael I. Rollins - Citigroup Global Markets, Inc. (Broker)

Hi, good afternoon. Thanks for taking my questions, two if I could. Just one, could you disclose what the postpaid revenues were in the quarter? I think it's something that you've given out in the past. I didn't see it in this quarter's release.

And then secondly, if we just take a step back on the wireline business, you talked about the investment you made, a lot of broadband for homes with the VIP project. How should we be thinking about the impact that should have on broadband units over time, being able to grow that residential broadband business? Does it take a certain amount of time before you get some benefit from the sales, or is there something else that we should be looking out for in terms of impact there? Thanks.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Mike, I'll let Mike and the team follow up with you on the details of the postpaid revenue details, and refer to what we put on the website. Whatever we give you, we'll make sure it's out there on the AT&T website. I don't have those numbers right in front of me.

With regard to the wireline business, the VIP project, and specifically I think, Mike, you're probably referring to the 57 million IP broadband locations, I'd suggest to you this. What we really need to see is the DIRECTV deal to close because the transaction, the key to being successful in that area is that customers want a bundle. And so with the closing of that transaction, we'll be able to have a bundle not only of the video services that DTV provides, but of the broadband services that we can provide.

As I mentioned before, about 30 million of those 57 million broadband locations, a little bit under that number, don't currently have a video product. Once we can do a real bundle with owner's economics and provide the efficiencies of one truck roll, the efficiencies of one service call, the efficiency of one troubleshooting call for the customers, one offer, one pricing structure, we believe that that will not only be good for our company, but it will be very good for customers that they'll have a new competitive offer out in the marketplace.

And so we think that the completion of our DIRECTV-AT&T merger is a key factor in that process and a key factor in bringing great quality services to customers. And from our surveys and from the information I've seen, it's what customers want. So that will be the focus point. I would suggest to you that we'll probably have more to say on that and give some insights to that when we have our Investor Day, which will likely be within about a month after the closing of DTV.

Michael I. Rollins - Citigroup Global Markets, Inc. (Broker)

Thanks very much.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Sure.

Michael J. Viola - Senior Vice President of Corporate Finance, AT&T, Inc.

Okay, Tony, we'll take one more question.

Operator

Thank you very much, and that question will come – Colby Synesael with Cowen & Company. Please go ahead.

Colby A. Synesael - Cowen & Co. LLC

Great, I have two, if I may. The first one, I was wondering if you can give us an update on your fixed wireless strategy. I know that was part of VIP a while ago, but I was wondering if it's changed at all with what you received in the AWS-3 auction.

And then the second question is, it's my understanding that for the AWS-3 debt that you raised to pay for those proceeds that you're capitalizing that interest. I was wondering if you could just talk about how much debt is actually being associated with the AWS-3 auction. Thanks.

John J. Stephens - Chief Financial Officer & Senior Executive VP

So first of all, your second question on AWS, yes, we are capitalizing that, and the amount of the debt that is being associated with that is a ratable share of our overall debt portfolio. The overall interest cost has come down significantly over the last three years as we've refinanced debt. But it is an allocated share based on the $18 billion, approximately $18 billion purchase price. So that is what is getting capitalized.

With regard to the fixed wireless local loop, Colby, I wouldn't suggest to you that anything's changed at this time. We still have the commitments out there in the DTV transaction, and we still stand ready to live up to those and to satisfy those in full. We think that's a clear benefit for the consumer and the marketplace as a part of that transaction. But we're still confident that we can satisfy that, and we'll see how that comes out. That's probably – the finalization of the DTV deal is probably going to have to come before we're going to go through and I'd be ready to discuss any modifications, if any, to the fixed wireless local loop plans.

Colby A. Synesael - Cowen & Co. LLC

Okay, thank you.

John J. Stephens - Chief Financial Officer & Senior Executive VP

Thank you. With that, I want to thank all of you for being on the call today. Our work the last few years sets us up for a transformative 2015. We are ready to move quickly once the DIRECTV and Nextel Mexico deals close. Our networks are in place, our customer transformation is on track, and we are seeing tangible results in our Digital First and software-defined network initiatives. Our performance in the first quarter adds to that confidence.

Wireless turned in another solid performance in a competitive environment. Wireline's focus on profitability and strong demand for IP services brought margin stability and growing IP revenues. We are ready for our Next transformative steps and we are excited about the opportunity we have before us.

One last thing before we go, as a good friend of ours, Kathy, would tell you, on your way home tonight, don't text and drive. It can wait. Thanks again for being on the call. And as always, thank you for your interest in AT&T. Have a good evening.