Operator

Ladies and gentlemen, thank you for standing by, and welcome to the AT&T Third Quarter 2011 Earnings Release. [Operator Instructions] As a reminder, today's call is being recorded. With that being said, I'll turn the conference over to Brooks McCorcle, Senior Vice President, Investor Relations, Finance. Please go ahead.

Brooks McCorcle

Thank you, John. Good morning, everyone, and welcome to our third quarter conference call. It's really great to have you with us this morning. As John mentioned, this is Brooks McCorcle, head of Investor Relations for AT&T, and joining me on the call today are John Stephens, AT&T's Chief Financial Officer; and Ralph de la Vega, AT&T's President and CEO for Mobility and Consumer Markets. John will cover our consolidated and Wireline results, and Ralph will give us an update on our Wireless business. Then, we will follow with Qs&As. Let me remind you that our release, investor briefing, supplementary information and the presentation slides that accompany this call are all available on the Investor Relations page of the AT&T website. And as a reminder, that's www.att.com/investor.relations.

I also need to reference our safe harbor statement, which is on Slide 3, and that says that this presentations -- this presentation and the comments that we'll make this morning may contain forward-looking statements. And as you know, they're subject to risks and details can be found in our SEC filings and on AT&T's website. Before I turn the call over to John, let me quickly call your attention to Slide 4, which provides the financial summary. Earnings per share for the quarter was $0.61, a 13% increase over last year's earnings per share, excluding onetime gains and up 3.5% year-to-date. This includes pressure from storm and T-Mobile transaction-related expenses in the third quarter. Our consolidated revenue was stable and consolidated operating margin was up 260 basis points year-over-year and stable sequentially, thanks to our best wireless service margins in 6 quarters and continued strength in Wireline business. Cash flow was superb. Cash from operating activities for the quarter totaled $10.4 billion and free cash flow was $5.1 billion, which brings us to $12.4 billion through the year. That's even with the increased investment in capital expenditures that we told you about last quarter. With that quick overview, I will now turn the call over to AT&T's Chief Financial Officer, John Stephens. John?

John Joseph Stephens

Thanks, Brooks, and good morning to everyone on the call. Before I cover results, let me provide a quick comment on our planned T-Mobile merger.

The SEC review is continuing and on the DOJ front, we're hopeful that we can reach a solution. We have a trial date in less than 4 months. The benefits of the combination are both significant and unchanged, and our expectation continues to be that we will reach a successful conclusion.

Now, let me turn to results and comment on the quarter overall, the highlights are on Slide 5. We are very pleased with what we've accomplished in the third quarter and year-to-date, and we continue to see impressive strength in all our growth engines. Mobile broadband leads the way. Ralph will give you more details in a moment but we had a great quarter. Sales were strong across the board, with gains in every subscriber category. Smartphone sales were robust, even in a quarter where you might expect sales to slow. Branded computing devices were also strong, and we turned in impressive service margin results with our best performance in 6 quarters. There also is good news for our Wireline business, where for the first time in 3 years, we posted sequential growth in total and business revenues. IP data continues to be the driver for business and in Wireline Consumer, where we continue to see positive results. The thing I'm most encouraged by is that in addition to solid earnings, we delivered excellent free cash flow. In fact, we had our strongest free cash flow in 2 years. That comes even with making significant CapEx investments. So you're seeing solid execution in every area of the business, which puts us in a great position heading into the fourth quarter.

With that as background, let's take a look at detailed results, starting with consolidated revenues on Slide 6. Third quarter consolidated revenues were stable sequentially and year-over-year, but when you look at our results year-to-date, we've seen revenues increase. Our growth drivers continued to be strong. Excellent mobile broadband growth, solid U-verse gains and improved business trends. This was partially offset in the third quarter by declines in voice and directory. We also had an iPhone launch last year, which provided a lift to 2010 third quarter equipment revenues. Of course, we didn't see this in third quarter revenues this year. So when you factor out equipment revenue, consolidated service revenues actually grew 0.4% versus a year ago. Our overall revenue mix has continued its transformation. Year-to-date, 75% of our revenues come from wireless and Wireline data and managed services. That's up from 72% a year ago and 66% just 2 years ago. Revenues from these areas were up 7% year-to-date, so they're growing at a very good clip. We expect this mix shift to continue, and it's one of the reasons we have such a positive view of our business. With that, let me turn it over to Ralph de la Vega, who will provide an update on Wireless results. Ralph?

Ralph de la Vega

Thank you, John, and good morning, everyone. It's great to be with you again. As John mentioned, we are excited about the incredible growth that we're seeing in our mobile broadband business. As you can see on Slide 7, the third quarter continued the strong sales momentum that we have seen throughout the year. Smartphone sales have been strong, 4.8 million this quarter and 16 million sold so far this year, exceeding even our most optimistic forecasts coming into the year. We're also seeing strong sales of data-only branded computing devices coming close to our best quarter ever. But you know what? We believe the best is yet to come. In the third quarter with those steps to make, the AT&T network experience even better.

First, we surpassed our end-of-year enhanced backhaul target, and we see this as a major tipping point for speeds on our network. Our enhanced backhaul now carries more than 2/3 of our data traffic. When you combine this with the advanced technology of HSPA+ devices, such as the iPhone 4s, we're seeing some incredible speeds across our 4G network. We also launched our first LTE cities in the third quarter. By the end of the year, we expect to have LTE service in at least 15 cities covering 17 million POPs, and we'll be turning up Boston and Washington D.C. next.

On the smartphone front, we have several new ones this quarter. We're off to a very fast start with the iPhone 4s. In fact, it's been our most successful launch in history, activating more than 1 million iPhone 4s' through Tuesday. Only AT&T's networks let the iPhone 4s download twice as fast and surf and talk at the same time and customers just love those features. We also have some really great Android devices that we announced last week, including the Motorola ATRIX 2. And in the fourth quarter, we plan to launch our first LTE handsets. Customers who love the state-of-the-art LTE smartphones we plan to introduce, they will be fast, they'll have super bright screens and long-lasting batteries. These new devices, along with an expected seasonal push we get from the holidays, sets us up for a really strong fourth quarter. In fact, we expect the fourth quarter to be one of our strongest smartphone sales quarters ever. But before we look too far ahead, let me drill down and cover third quarter Wireless results, and there's no better place to start this quarter than in our net adds and churns. The details are on Slide 8. We hit a benchmark this quarter when we passed 100 million subscribers, adding more than 2.1 million this quarter alone. We also continued the trend that we have been seeing so far this year, with growth across the board in every customer category. That includes postpaid net adds of 319,000 or about the same number we had in the second quarter. Excluding the impacts of the Alltel and Centennial integration migrations, postpaid net adds were 384,000. Prepaid net adds were 293,000, more than twice as many as we had in the second quarter, helped by strong GoPhone sales, and we had another solid reseller quarter, with 473,000 subscribers added.

We also added 1 million connected devices in the third quarter. This is a terrific business for us with lower ARPUs, with good margins and low churn, plus most of these devices have little or no subsidy. And speaking of churn, total churn improved both year-over-year and sequentially. Postpaid churn was stable, and we saw iPhone churn decrease, a tremendous vote of confidence in a very competitive environment. It seems like a long time ago when the issue of how we would perform with iPhone competition was top of mind. Well, I think and believe that our results speak for themselves. These results speak volumes about our wireless business. New customers are choosing AT&T and existing ones continue to stay with us.

Now, let's look at revenue and postpaid ARPU on Slide 9. Our track record of postpaid ARPU growth is unmatched in the industry. This is our 11th consecutive quarter of growing postpaid ARPU. And we grow it from a much larger ARPU base than anyone else. Last quarter, our postpaid ARPU was more than $7 higher than our closest competitor. In the third quarter, our postpaid ARPU was almost $64 per subscriber. Postpaid ARPU for the third quarter grew 1.4% year-over-year. Looking ahead, we expect ARPU to increase to the 2% range in the fourth quarter, thanks to expected positive impacts from higher smartphone activations in the quarter and from the pressure of the Alltel integration being fully behind us. Total serviced Wireless revenues were $14.3 billion, up $600 million or 4.3% from the year earlier. This was driven by subscriber gains and strong adoption of data plans, which was offset somewhat by the lack of an iPhone refresh in the quarter. And we continue to bring in more subscribers onto our network with pure data plans. 18 million or nearly half of our smartphone subscribers are on tiered plans with most choosing the higher priced data plan. Our lower price plan continues to be a good entry point for many subscribers and now that we offer a free iPhone with a 2-year contract for the first time ever, the iPhone 3GS, we expect to broaden the smartphone base even more.

You can also see the benefits of mobile broadband sales in our wireless data results, which are on Slide 10. Data revenues were $5.6 billion, up more than $850 million from the third quarter a year ago. Data revenues are now at $22 billion annualized revenue stream for us, growing at 18% year-over-year. Compare that to just 4 years ago when the mobile broadband was just beginning to emerge. Back then, it was just a $7 billion annualized revenue stream. So we have tripled that number in just 4 years. We've come a long way, yet we're still just getting started.

We also hit a significant smartphone milestone this quarter. Smartphone subscribers now make up more than half of our postpaid subscriber base, 52.6%, up from 39.1% a year ago. At the same time, smartphones continue to be nearly 2/3 of our postpaid sales during the quarter, showing more opportunity for growth. ARPU for smartphones continued to be strong, 1.9x that of other devices and customers tend to be sticking with churn below our average. We also delivered another strong quarter for branded computer subscriber growth. This is a new growth area for us that includes data only connections, such as tablets, tethering and aircards. And as you can see, the results continue to impress. We increased sales by 505,000 to reach 4.5 million.

We are really excited about the opportunities here. There are a lot of exciting new tablets and new data-driven products on the horizon, and we have the right business model, the right products and the right network to really grow this business. Now, let's take a look at wireless margins, the details on Slide 11. In addition to subscriber and top line growth, wireless margins expanded this quarter. In fact, we had our best wireless service margin performance in 6 quarters. This comes even with another strong smartphone sales quarter. Our third quarter wireless service EBITDA margin was 43.7%, and when you factor in Alltel and storm pressures, margins would've been more than 44%.

I think it's worthwhile to take a moment and compare this quarter's results to the second quarter a year ago. That's the last time we had a quarter before an iPhone refresh. What you see is interesting and promising. Our service margins this quarter were actually better, and we sold almost 1 million more smartphones than we did the second quarter a year ago. And I think this really speaks to our long-term goal of building a strong smartphone base while working to improve margins. It's important for us to keep our long-term strategy in mind as we plan for the fourth quarter. As I mentioned earlier, we expect blockbuster smartphone sales in the fourth quarter. You've seen the earlier response to the iPhone 4S, and it's been tremendous. Plus, when you factor in a great lineup of other smartphones, new devices from our LTE launch and traditionally strong holiday sales, you start to get an idea of the kind of quarter this is shaping up to be. Obviously, this will impact margins in the fourth quarter but the benefits are clear, including lower churn, higher ARPUs and strong data growth and the opportunity to create long-term value is substantial. That covers wireless. Now, I'd like to turn it back to John Stephens to discuss Wireline and consolidated results. John?

John Joseph Stephens

Thank you, Ralph. We always appreciate you being on the call, especially when you bring such great results. Now, let's take a look at our Wireline business, where we had our first sequential revenue growth in 4 years. Let's begin with Wireline Consumer and U-verse. Slide 12 has that information. We believe we have the best video experience in the business, but you don't have to take our word for it. J.D. Power has once again named U-verse highest in overall customer satisfaction and that's in every market that we serve where J.D. Power measures us. I strongly believe the best is yet to come. Our goal is to take the best video experience and make it even better.

Earlier this week, we announced several connected TV apps that will further integrate our TV and wireless platforms, and there are several other really great new features that are coming soon. As U-verse has transformed the viewer experience, it has also transformed our consumer results. IP data, that's U-verse plus other consumer broadband, now represents an annualized revenue stream of almost $11 billion, growing over 19% year-over-year and making up more than half of our consumer revenues. During the quarter, we added 176,000 U-verse subscribers to reach 3.6 million in service. Our subscriber numbers were impacted somewhat this quarter by a technology upgrade and storms in some of our U-verse service areas. This caused us to pull back on some installations to handle those situations. But sales remained strong, and we feel confident that our subscriber net add levels will improve in the fourth quarter.

We're also seeing broadband and U-verse voice over IP attach rates remaining solid. More than 3/4 of U-verse subscribers have a triple or quad play bundle with us. ARPU for these customers is about $170, up 6% year-over-year and penetration continues to grow. We now have 25% penetration in areas marketed to for 36 months or more and we believe there's a lot of room for growth. U-verse high-speed data also had another great quarter, adding more than 500,000 subscribers. Our U-verse broadband net adds were more than twice our TV additions, with many of these subscribers buying our newer and faster IP DSL broadband service.

Now, let me provide a quick update on improving trends we are seeing with our Wireline business customers, which you can see on Slide 13. Thanks to robust growth in our strategic business services, we had the first sequential growth in our Wireline business revenue in 3 years. That's sequential growth for the first time in our Wireline business revenue in 3 years. And what makes this even more impressive is that this growth is occurring while we're still seeing pressure from the weak economy, slow employment and the transformation of our business to next-generation IP products. So while business continues to work their way through the economic downturn, they are still investing in services that help drive productivity and efficiency.

Business service revenues were down 2.2% year-over-year on a reported basis and 1.7% when you adjust for last year's sale of assets in Japan. But when you look at sequential results, revenues were actually increasing. Much of this success is attributable to continued strong growth of our strategic business services, revenues from products such as ethernet, VPNs and application services, which is an almost $5.8 billion annualized revenue stream and growing at 19.3% in the third quarter and 19.1% year-to-date. So we're not only growing the revenue but continuing to grow it at a slightly larger rate.

We are seeing data growth across a variety of industries and customers, both large and small. Global IP data and integration services are growing at more than 10%. Wholesale had its second sequential quarter of revenue growth, and we had our first quarter of broadband growth in 2 years in small business. Our wireless bundles are also increasing. These are very encouraging signs, and we plan to build on this success as we go forward.

Now, let's look at margins and cash flow. Consolidated margin comparisons are on Slide 14. We said in January that we expected to deliver stable to improved consolidated margins this year, with wireless margin expansion and a disciplined focused on cost initiatives. Through the third quarter, I think it's fair to say we're delivering. Our consolidated operating margin was 19.8%. That's up 260 basis points versus the third quarter a year ago and up sequentially. And when you adjust for the storms, the technology upgrades and the Alltel costs, we would've had margins of over 20%. Our reported Wireline operating margin was 12.1% in the third quarter, down both sequentially and year-over-year. While we remain focused on cost initiatives, our results were pressured from declines in voice revenues, storm expenses, technology upgrades as we mentioned earlier. If you take those costs into account, our margins are in the mid-12% range. Our one AT&T initiatives are continuing to make progress. We continue to target cost efficiencies and simplify product offerings to deliver best-in-class services while also achieving cost savings. These initiatives are going well and help us sustain solid margins while still serving customers with the best-in-class operation.

Along with solid margins, we continue to have strong cash flows. Our cash summary is on Slide 15. Through the first 9 months of the year, cash from operations totaled $27.2 billion, up 7% from a year ago. Capital expenditures were $14.7 billion. Free cash flow before dividends was $12.4 billion with our third quarter free cash flow at its highest level in 2 years and up 7% for the year. And dividend payments totaled $7.6 billion. In terms of uses of cash, net debt is down more than $8 billion over the past 5 quarters, and our net debt to EBITDA ratio is 1.41. Our balance sheet is solid. Our debt metrics sound, and we have more than $10 billion of cash on hand. Our strong cash flow gives us the flexibility to invest in our business, to retire debt and to continue to return substantial value to shareholders.

Let me close with a quick recap on Slide 16. First, we are seeing great execution across the business, strong gains in all our major growth drivers, mobile broadband, U-verse, strategic business services. Second, as Ralph said, mobile broadband growth has been terrific, and the fourth quarter is shaping up to be one of our best yet. Data revenue growth is strong. Churn is down. Smartphone sales continue to grow. And maybe the biggest news this quarter is the first sequential revenue growth from business Wireline customers in 3 years. Overall, these results produced another solid quarter for us, with double-digit adjusted earnings growth and strong free cash flow, allowing us to have one of the strongest balance sheets in the industry. And as I mentioned earlier, we continue to move ahead with our efforts on the T-Mobile transaction. Brooks, that concludes our prepared remarks. I think we're ready for Q&A.

Brooks McCorcle

Great. John, I think we're ready to take our first question.

Question-and-Answer Session

Operator

[Operator Instructions] And first, we'll go to Simon Flannery with Morgan Stanley.

Simon Flannery - Morgan Stanley, Research Division

Ralph, good Wireless results given all the headwinds out there. Can you talk about at the LTE rollout? You've had it for a few weeks now. What are you seeing from that? And how should we think about LTE over the next few quarters? To what extent are you going to be able to sort of drive incremental revenues, incremental ARPU from this, as well as driving better efficiency gains from your sort of experience so far? I know you've made some comments about your upcoming smartphones and how they would have improved battery performance and so forth, so some color around those issues would be great.

Ralph de la Vega

Simon, I am thrilled about what we're seeing with the LTE launch. I have been a part of many network and device transformations. And this technology quite frankly is the best I have ever seen in my career. The network technology is fantastic. The devices are fast. They're thin. They have great battery life. It's the first time that I think a network transition is going to be a home run right off the bat. As we launched 3G, it took us about 6 months to a year to really get some really, really cool handsets. This is happening right now with our launch. So I think we've timed it perfectly. And when you complement that what we're doing with HSPA+, I couldn't be more happy. What I see happening with LTE and data, Simon, is just a huge growth opportunity. We mentioned today that our smartphones now make up 52% of our postpaid base. But I think the way we need to think about smartphones in the future is the smartphone is going to equal the phone in the future. It will be 100% in the next 2 or 3 years. These devices are so good and the costs are coming down so much that I think in the future, you could look at close to 100% penetration, not 2/3 like we're selling today. Huge opportunity in smartphones. And then you add on top of that these new devices like tablets and MiFis and e-Readers and telematics. And the growth opportunity is off the charts on this. And then you add to that the cloud, the fact that all of these devices in the future are going to want connectivity to the cloud, which means they need to have great bandwidth, great data capability. And this is not just the demand that we're seeing in this country but all around the world. And so our business enterprise can go and pitch products to them that are based on the worldwide standard today of HSPA and LTE in the future. So I see huge growth opportunities as more smartphones penetrate our base, huge opportunity with tablets and a huge opportunity to provide a worldwide capability on a standard technology platform that is probably the best the world has. And the great thing about doing all of that is that we're doing it with a technology, LTE, that provides a reduced cost per megabyte, that is we can produce the megabyte a lot cheaper on LTE, and it's also more spectrally efficient. So lower cost, lower spectrum requirements and great revenue potential. I'm very bullish on what we're seeing in data, and I think we've only seen the tip of the iceberg because customers love the devices that are coming out and they love using high-speed data.

Operator

Our next question is from John Hodulik with UBS.

John C. Hodulik - UBS Investment Bank, Research Division

The wireless quarter was strong. I think the one surprise was the deceleration you saw in the postpaid ARPU. Maybe either for John or for Ralph, are there any sort of incremental things you can call out with that 1.4% number, that maybe fall out or is it just a function of people waiting for the new iPhone and that reversing in the fourth quarter, that drives the reacceleration?

Ralph de la Vega

John, this is Ralph. While there’s several puts and takes, I think the primary driver of ARPU in the third quarter was lower smartphone growth. And they're very closely correlated. And so we expect that as smartphone growth continues in the fourth quarter, the third quarter was slower than normal because we didn't have an iPhone refresh in the third quarter. But the fourth quarter is going to be unbelievable. And so we expect to probably have the best fourth quarter smartphone sales we've ever had. And so we expect that growth to pick up, and we expect ARPU to pick up just as well. We're very confident of that. That's why we commented that we think hitting 2% is what we expect to see in the fourth quarter, which is right in line with what we have been seeing.

Operator

Next, we'll go to Craig Moffett with Sanford Bernstein.

Craig Moffett - Sanford C. Bernstein & Co., LLC., Research Division

Given the decline in interest rates and sort of tepid returns in the market, John, can you just comment on what you expect in terms of cash contributions to the pension at the end of this year, and then a related issue on the reversal of stimulus or cash taxes?

John Joseph Stephens

Sure, Craig. Let me tell you, first of all, with regard to the pension funding issue, there is some processes that we have to go between -- that every company has to go through between now and the end of the year, not only seeing how our investment results and discount rates and so forth change and results are come out at the end of the year, but also to make some decisions on funding elections that are available to companies today. We'll make those decisions at the end of the year and make our determinations on funding at that time. I will tell you, with that being said, we commonly follow and review this process and in all our business plans and processes going forward. We have assumptions for pension funding and believe that we can handle those in normal course of our business within the normal course of cash flows that we are now generating. And quite frankly, they're also tax-deductible, so while the funding dollars going in at 100%, we get the tax benefits that come back at about $0.40 to the dollar. So that's the issue with funding. We'll have more knowledge about that as the results come in for the plans and as we make our elections on funding. Second, second piece on cash taxes, certainly the bonus depreciation rules have provided us a benefit this year, as tax planning has provided our company benefits for a number of years. This quarter is a great example because in comparing year-over-year results, when we show our 13% growth in earnings per share. That's after taking out a significant tax gain out of last year's results. So my point being though is as with the bonus depreciation rules that it provides us, we continue to plan for that. That payback period is a couple of years out for us, and we expect to have other opportunities to offset some, if not all, of that cash pressure.

Operator

Our next question is from Phil Cusick with J.P. Morgan.

Philip Cusick - JP Morgan Chase & Co, Research Division

Lets switch over to the Wireline a little bit, can you talk about how we should think about margins going forward and what you expect for the consumer business in terms of promotions around broadband and DSL? I assume that we had some tax that were allocated to different areas in the third quarter. How should we look at that going forward?

John Joseph Stephens

First of all, the margins, I like to look at the Wireline margins from an operating income perspective and from an -- and an EBITDA perspective. But if you look at this quarter, we came in around 32% for our EBITDA margins if you adjust for the storms and the technology upgrade costs. And we came in around 12.5% if you do those same adjustments on an operating income basis. I think on a full year basis, we're probably in the 10 to 20 basis points lagging on an operating income basis, last year's operating income margins for Wireline. So we're hopeful that we can make that up in the fourth quarter. We'll see if we can or not, but we're hopeful about that. So we continue to believe that we have an opportunity to sustain margins at this level or even slightly better than we've done in this quarter, and we're working hard to do that. It is a challenging endeavor. Specifically, as you all know, transforming the business from high-margin legacy products to these next-generation U-verse IP and other services. With regard to our DSL, the most encouraging piece of the DSL story, and while our net adds for the quarter were about in the 5,000 range. The most encouraging piece of it was the fact that we had 500,000 high-speed U-verse/IP DSLAM net adds. So we were able to convert a huge piece of our legacy DSL base into U-verse/IP DSLAM, and we saw gains in small business with that IP DSLAM product for the first time. We'll continue to focus on transforming those DSL lines into high speed. We get great speeds, great service to our customers, good ARPUs. On those areas where we don't have U-verse, I think our plans have been fairly clear. We expect to have an LTE rollout to 97% of the country. And as Ralph talked about, we're getting great results where we have it so we believe that's going to be able to provide a wireless solution at a high speed, good quality, good cost on a profitable basis for us. That's the long-term solution to the non-U-verse areas.

Ralph de la Vega

And, Phil, in terms of your question about promotions, in the third quarter, we based our promotions on a market-by-market basis, only where we had installation capacity. And so we expect that some of those markets will be opened up in the fourth quarter. Now that we've got the technology transition behind us, you'll see a broader number of promotions in the fourth quarter back to the way we were at kind of second quarter and prior to that.

Philip Cusick - JP Morgan Chase & Co, Research Division

So we should look for video to rebound in 4Q back to sort of the 2Q and prior level?

John Joseph Stephens

We expect to rebound in the fourth quarter.

Operator

Our next question is from Michael Rollins with Citi Investment Research.

Michael Rollins - Citigroup Inc, Research Division

Just 2, one to follow-up on the margin side. It looks like as we look at the third quarter outperformance in the margins, significant portion of that came from slower device sales partly related to the iPhone. Can you talk about your expectations for getting you a mid-40s margin while having a more normalized rate of device refresh, given that as time goes on and more people have smartphones, they'll replace those devices with smartphones? Second quick question was just to get your initial expectations out of the pending FCC proceeding to reform intercarrier comp and USF where the vote scheduled to come up in, I guess, a little over a week?

John Joseph Stephens

Mike, let me take a shot at the margins. I understand your comment about handset sales impacting margins and they clearly do and they clearly will in the fourth quarter. But with that being said, I think Ralph covered it. For our margins for the quarter reported basis of 43.7%, when you adjust for the merger cost, the close to 44%, they included almost 5 million smartphone sales. And when you compare it to the prior quarter before an iPhone launch, our margins are not only 60 basis points higher but we have almost 1 million more smartphone sales. And so our point is that while someone may jump to the conclusion that it's a handset driven, and certainly the handsets have an impact, the reality of it is there was a lot of good hard work by the entire management team on all fronts to generate these great margins. It wasn't just a differential on handsets because I sold 900,000 more handsets this quarter than I did in the last pre-iPhone launch. That's the first point. And, Ralph, did I miss anything with that?

Ralph de la Vega

I Think you did a good job.

John Joseph Stephens

Last thing, Mike, with regard to the FCC, the intercarrier comp process is important. The issue is important to us. We've continued to participate and provide our input to it. I think you're aware, we're a net payer in that environment. So some movement of those costs to more of an economic base could have a positive impact on us. So we're supportive of the efforts, trying to participate in a constructive way for the entire industry and we look forward to seeing what the commission comes out with. And as you know, the devil is always in the details. So we're going to really be careful to make sure we do a good analysis of it. But generally speaking, we're very positive towards the idea of getting a refresh of those rules based on current economic conditions.

Operator

Our next question is from Michael McCormack with Nomura Securities.

Michael McCormack - Nomura Securities Co. Ltd., Research Division

Ralph, can you just give us maybe a little more detail on expectations for this sort of 2% type level in ARPU growth in 4Q? Just thinking about maybe more nonsmartphone to smartphone or iPhone upgrades, a change in the upgrade versus new customer ratio, maybe some color around the Alltel impact that's going away in 4Q, and then on the iPhone 4s, whether or not we should be thinking about that more as a front-end loading versus more of a holiday, which has been the case I think historically. And then lastly, just sort of more detail on the U-verse technology upgrade, was that also including IP DSLAM or was there something else involved there?

Ralph de la Vega

Mike, concerning the 2% in the fourth quarter, what we typically see when we have a strong smartphone growth quarter is a lot of customers who are on feature phones and what we call quick messaging devices step up to the smartphone category. And that's what we expect is going to happen in greater numbers in the fourth quarter. Third quarter was simply slow because we didn't have an iPhone launch in the third quarter like we did a year ago, but we think that's going to dramatically change and get those back into 2% range. I also mentioned in my notes that we have another device that I think is going to dramatically change those people that are on smartphones and quick messaging devices, the 3GS, which is free with a 2-year contract. We've seen a tremendous, tremendous demand for that device even though it's a generation old. And actually, we're getting more new subscribers coming on the 3GS on the average than other devices. So we’re also out of inventory, sold out on that device. And so I'm very, very optimistic on what the fourth quarter is going to look like in terms of smartphone growth. And that's what typically drives the ARPU growth, Mike. So we feel very, very confident. The Alltel impact was in the range of about 23 basis points, Mike. But the majority of it was driven through smartphone growth, and we are very confident that's going to pick up in the fourth quarter. Okay, the other question on the technology upgrade. Typically, when we provide new upgrades to U-verse, we required a few more dispatches so we planned for that. This time, we reduced promotions so that we could provide good service intervals to customers when they reported any issues with the transition. It worked extremely well. That work is behind us, and now we'll go back to the regular output -- mode of business in the fourth quarter.

Michael McCormack - Nomura Securities Co. Ltd., Research Division

Ralph, the technology upgrade though, is that just getting higher speeds as a competitive response to DOCSIS 3.0 launches or something else?

Ralph de la Vega

No, it's more feature related, a slew of new features and you're going to see -- that was the basic upgrade platform. You're going to see us now roll out new features in the next 2 or 3 months of how to connect your smartphone to your U-verse TV, connect your iPad, watch complimentary content, all kinds of new connectivity options that are going to become available now that the platform has been upgraded.

Operator

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

David W. Barden - BofA Merrill Lynch, Research Division

John, just to start, could you just revisit kind of the CapEx outlook that you kind of see for 4Q? Obviously, we've had a number of companies that are suggesting that things are slowing down quickly at AT&T. If you could kind of just -- but yet, year-to-date spend seems to be pretty healthy. So I just kind of wanted to see if you could give us a peek into the rest of the year for the CapEx plans. And then second if I could, Ralph, just taking another kind of crack at this topic. You guys are talking about half the smartphone base on tiered plans, which means that half the smartphones are still paying you kind of $30 a month and as those guys upgrade their phones and as their life cycle evolves, they'll probably move down the curve. And you've already gotten more than half your base on a smartphone, so the next 47% of your base is going to be taking cheaper smartphones and maybe cheaper plans and maybe not taking a smartphone at all if they can afford it. So as you look down the track with this pressure on the existing smartphone base to lower ARPUs to the existing tiers and the next half of the smartphone base being the lower tiered customers, are you still optimistic that the ARPU can grow in the face of those forces?

John Joseph Stephens

David, let me break a comment, the questions between Ralph and I and I'll take the CapEx question first. I think our guidance remains unchanged. We're in that mid-$20 billion range. I think we're just under $15 billion year-to-date at $14.8 billion or so, so we're at kind of on a run rate that's consistent with what our guidance is. That's the first thing. The second thing is our free cash flows allow us to make this investment. I mean, our operating cash flows are great, and they're what's funding this. Third, we're going to continue to invest, and quite frankly, push for investment in our LTE and all of our successful growing products. So we'll continue to make that. And I expect our CapEx will run in that $20 billion range. Don't expect it to be certainly any expectations of anything other than continuing. And quite frankly, we'll ramp it up a little bit just to get to that mid-$20 billion range.

Ralph de la Vega

In terms of the capability to grow ARPU, I think that as I mentioned before, we're going to see customers use more data, not less. I don't see an environment going into the future where customers are going to use less data. These products are too good. There's an incredible amount of streaming content that's available. So we're going to continue to see customer data usage increase. We have not seen a decline, and I don't see it any way to decline. That's why I feel so bullish about our position of having 50% of our base already on tiered plans, and we plan to make available more tiered options for customers in the future so they can enjoy the data services that they want. So what I see is exactly the opposite of the scenario you suggested is where everybody is actually using more data. I see it across every product category we sell and that more handsets that we get into a customer's hands that are smartphones, the more data that they use, not the less.

John Joseph Stephens

And, Ralph, to add to that, David, I mean, we continue to add to that tier data plan group of customers. It's over 18 million now. And if you think about it, we built that 18 million base in not much more than a year. And so we've got a lot of levers with that, and it's working well. You've seen what our churn has been like in the last year after implementing that. And quite frankly, I don't think you've noticed any harm certainly, if not a benefit to our churn level. So we feel like we're really positioned for that growth. And not only from a network capability and quality of service but also from an ability to capture the revenue.

David W. Barden - BofA Merrill Lynch, Research Division

Okay, that's helpful. If I could just ask one quick follow-up, Ralph then, from a usage standpoint, what is overage from the tiered plans contributing to ARPU today?

Ralph de la Vega

I can't give you an exact number, but we do have overage from both plans. So they're actually small right now. I think that they're not significant overages, but like I said before, we plan to make available more options to customers that may need higher usage categories in the future, so they can feel comfortable in stepping up but not feeling that they're having to pay an exorbitant amount. We want to encourage customers to use more and incur a little more cost if that's what they want to do or stay with the plans that they have. But we're going to have lots of data options. The other thing that I feel so bullish about is what is happening in the tablet arena. I mean, it's very obvious to me that this tablet revolution is going to continue. I don't see anything in the horizon that stops it, and I think customers are going to want both, some smartphones and a tablet. And they're going to see their content on the tablet in ways that's going to make them use more and more data. So I think the future of tablet computing is going to be very good for our industry.

Operator

Next, we go to Jonathan Chaplin with Crédit Suisse.

Jonathan Chaplin - Crédit Suisse AG, Research Division

I just wanted to follow-up on the Wireline margins a little bit. John, sensing sort of a shift in the rhetoric, I just want to make sure that I've got it correctly. I was under the impression that you guys have made sort of tremendous progress on costs in the Wireline business so that when we saw that ramp in revenue growth in Wireline, we'd start to see sort of meaningful margin expansion. And we've got the revenue growth this quarter but the margin expansion didn't come through. And you sort of attributed some of it to storms, some of it to just a negative mix shift. Wondering if you can pull those 2 issues apart a little bit? And just give us an update of whether we should start to see margin expansion as revenues continue to grow in the Wireline business? Or whether this mix shift is just bigger than expected?

John Joseph Stephens

Okay Jonathan, I guess, just real quickly, I do believe that the margins for the quarter were impacted by the storms and other things, so I think that 12.5% and more of a 32% range for the EBITDA margin for the Wireline is appropriate for this quarter. With that being said, I still believe that there is an opportunity to grow revenues as we're showing and then to have that impact on margin. Quite frankly, the distinction for this quarter is wow we did grow revenues and I am thrilled about our total Wireline and our business Wireline revenues growing. The growth was not dramatic. I don't think anybody would've expected it to be dramatic in this economic environment. And so it's going to take time to get more significant growth and also, we're still feeling the pressures of the legacy products, whether it be the legacy excess lines or high-margin products transitioning to lower margin, things like U-verse. But I still think there's that opportunity. It's going to take some time. Right now, we feel like we're doing a good job of managing those expenses, getting focused on them and holding margins in line with what were our expectations for this year. I hope that's helpful, Jonathan.

Operator

Our next question is from Jason Armstrong with Goldman Sachs.

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Maybe just a couple on Wireless, just -- sorry, one more on ARPU, but I think a lot of the questions are focused on data. Maybe I'll angle it towards voice. If we can just talk about the opportunities to sort of level out voice ARPU, certainly on phone plans. We’ve still seen deterioration, I think that was probably the bigger surprise this quarter, but data ARPU was sort of in line with expectations. Voice ARPU was a little bit worse. What's going on there is that people still trading down minute bucket plans, and maybe it has a bit of a macro component? Is it still family-planning penetration that sort of riding that curve? Maybe just give us a little bit more granularity there and help us think about when that can level out because that's still 60% of the postpaid ARPU? And then second, just on handset upgrade rates, you had 7% this quarter. That’s the lowest rate we've seen in a while, obviously contributed a very strong margins. Help us think through this. Is this tied more to changes in upgrade policies which you guys made, which you lengthened some of the Windows or more tied to just lack of new handsets and hence, we should expect this to move back to the 8% to 9% range?

Ralph de la Vega

Jason, this is Ralph. Let me address both of those issues. In terms of the voice ARPU, what we saw in the first quarter, it wasn't a major impact. We had a smaller impact as a result of us implementing the mobile to any mobile plans in the third quarter. We think that those migrations that happened in the third quarter will not happen in the fourth quarter because those plans have already been implemented and are reflected in third quarter results. But the biggest impact to the third quarter ARPU number was still data. It wasn't voice. In terms of the upgrade, the changes in upgrade policy do not impact this year. They'll impact next year. And what we saw was just simply the fact that the iPhone refresh is taking place in the fourth quarter this year compared to the third quarter last year. The big unknown is what happens when you have an iPhone refresh in the fourth quarter, which is the busiest quarter of the year. And this is the first time that happens so we expect that it will be a little higher than average upgrade number in the fourth quarter. But it's hard to estimate because we've never seen this event before.

Operator

And that will be from the line of Brett Feldman with Deutsche Bank.

Brett Feldman - Deutsche Bank AG, Research Division

You guys had a pretty good prepaid quarter. Even if we adjust for some of the prepaid tablets, it looks like you might have had over 100,000 net adds in your traditional products. We haven't seen that in a very long time. You've actually been losing customers in that category for a while. So I was hoping you could just give us a little bit of color on why we've seen such a swift turnaround in that segment of your business.

Ralph de la Vega

Of course, that's a very good observation. We launched a new $50 GoPhone plan. We put in that plan also some handsets that are very attractive. They're low cost, but they've been a huge hit in the marketplace, so we're seeing that business resurge for us. And I'm very pleased with what we've seen in the GoPhone and we're just getting started. We have a very strong fourth quarter lineup, so I think we're going to continue to do well with GoPhone sales in the fourth quarter.

Brett Feldman - Deutsche Bank AG, Research Division

Yes, that was going to be my follow up because seasonally, it's one of the best quarters of the year, so should we expect that type of a seasonal improvement or you think maybe it'll be a little lesser, just because you got something really right in the third quarter?

Ralph de la Vega

I think they're going to be cumulative. I think the third quarter is a preview, that I think we have a good product that should actually play out stronger in the fourth quarter. It's always very competitive in the fourth quarter in the prepaid market, but we have a great product. We have a great price, and we think we're going to do very well.

John Joseph Stephens

Ralph, thanks for participating in the call today. It's always great to have you with us. And for all the analysts and owners out there, thank you for participating. Let me close by recapping a few key points. We had another solid quarter. We delivered adjusted double-digit earnings growth, strong consolidated and wireless margins and our best free cash flow in 2 years. In wireless, mobile broadband sales in both smartphones and data-only devices continued to be strong, and we had really encouraging Wireline results, including our first sequential revenue growth in Wireline business services in 3 years. Our job now is to execute and finish the year strong. We have good momentum heading into the fourth quarter, which makes us optimistic as we look ahead. Thanks again for being on the call today, and as always, thank you for your interest in AT&T.