Operator

Ladies and gentlemen, thank you for standing by and welcome to the 2016 AT&T's Second Quarter Earnings Call. At this time all lines are in a listen-only mode. Later there will be an opportunity for your questions and instructions will be given at that time. . I'll now turn the call over to your host, Michael Viola, Senior Vice President Investor Relations. Please go ahead, sir.

Michael J. Viola - Senior Vice President-Investor Relations

Thank you, Kathy, and good afternoon, everyone. Welcome to the second quarter conference call. It's great to have you with us today. Joining me on the call today is John Stephens, AT&T's Chief Financial Officer.

We're going open with a summary of our results and then we're going to spend a little bit of time providing a strategic update of our business. We thought this would be a great time to just take a step back and look at how we've repositioned our company the last few years. Let me remind you, our earnings material is available on the Investor Relations page of the AT&T website. You can find the material at www.att.com/Investor Relations.

Now beforehand I hand the call off to John, I need to call your attention to one more matter. That's the safe harbor statement which is on slide three. It says that some of our comments today may be forward-looking, they're subject to risks and uncertainties, results may differ materially, and additional information is available on the Investor Relations page of the AT&T website. I also need to remind you that we're in a quiet period for the FCC spectrum auctions and thus we cannot address any questions about spectrum today. And so with that, I'll now turn the call over to AT&T's CFO, John Stephens.

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

Thanks, Mike, and hello everyone. And thanks for being on the call today. It's been one year since we closed on our deal to acquire DIRECTV and it's been a heck of a year. We are hitting the mark with their synergy targets. Our cost synergies are ahead of plan and we're about ready to take the wraps off some exciting new streaming opportunities that will expand our customer base and extend our video position. We've added nearly 1million U.S. satellite subscribers since we closed the deal. We were excited a year ago when DTV first came on board, and that enthusiasm has only grown.

We'll talk more about that in just a few minutes. But now let me begin by discussing our second quarter results, starting with our financial summary on slide five. Second quarter consolidated revenues grew to $40.5 billion, largely due to our acquisition of DIRECTV. But we also saw a growth in satellite video, advertising, and IP services on a comparable basis. This offset pressure from lower year-over-year wireless equipment sales and foreign exchange.

Adjusted earnings growth continued. After adjustments, second quarter EPS was $0.72 a share, up year-over-year and up about 7% year-to-date. This quarter's growth comes even with about $0.03 of earnings pressure from our Mexico wireless operations. And, we had more than $0.01 of pressure from compensation-related programs tied to our stock price. Most of this is from a success-based compensation plan we have for our bargain floor (3:37) employees. We're please for our employees, all our employees, in that they have an opportunity to share in the success that they have helped create for our shareholders.

Margins also continue to be a solid story, thanks to our focus on profitability and our best ever wireless EBITDA margins. We once again saw adjusted margin expansion on a consolidated basis and in every domestic business segment.

This solid performance helped drive strong cash flows. Operating cash flow was $10.3 billion, with free cash flow reaching $4.8 billion, up 8.4% year-over-year. Our dividend payout ratio for the quarter was 61% and year to date, it's 73%. Capital investment came in at $5.6 billion for the quarter and $10.3 billion year to date. We also continue to find ample demand and great rates in the securitization market to help us manage our Next receivable. We received about $1.1 billion in the second quarter, or about the same as last year's second quarter.

Let's now take a look at our operations, starting with business solutions; those details are on slide six. Total business solution revenues were down slightly, due to the sale of certain hosting operations and foreign-exchange pressure. Solid wireless and strategic business service revenue gains helped offset lower wireless equipment sales and declines in legacy services. Business wireless revenues were up 2%, with service revenue growth outpacing equipment declines. Margins also continued to expand, thanks to business efficiencies and wireless revenue growth offsetting lower wireline revenues.

Looking at the customer segments, Small Business Operations continued to grow thanks to gains in wireless. Enterprise revenues were flat. However, if you adjust for the sale of our divested business and FX, that segment also continued to grow in the quarter. Strategic Business Services continues to grow at a healthy clip, up more than $200 million year-over-year. That's up 8.4% on a reported basis, and when you adjust for FX, growth was 9%.

Strategic Business Services are now 36% of business wireline revenues. The growth of Strategic Business Services and Mobility is changing the revenue mix in Business Solutions. Those two areas now make up more than 70% of Business Solutions revenues, and if you look at total data and wireless, that's more than 80% of business revenues. So our transformation to next-generation products and services is well on its way in our business segment.

Now let's move to our Entertainment group results on slide seven. On a comparative basis, we grew revenues in our Entertainment group thanks to gains and satellite subscribers, broadband revenue, and advertising. This more than offset losses in legacy services while also overcoming the pressure from the record-breaking Mayweather/Pacquiao pay-per-view event in the year-ago second quarter.

We continued to see solid gains in broadband and advertising revenues. Broadband revenue was up nearly 7% in the quarter, with IEP broadband revenues up 15%. Advertising sales also continued its strong growth, up double digits year to date, and it's now more than a $1.4 billion annualized revenue stream. We're well positioned in this space and we're looking to play a leading role in taking our ad offerings across all screens. At the same time, we again saw continued margin expansion, which points directly to the benefits of the DIRECTV acquisition. Our margins on a comparable basis were up 90 basis points, and were up even more if you adjusted for the prior year pay-per-view event.

Our second quarter customer video metrics were impacted by the usual seasonal pressures but improved nicely over last year. Our satellite net ads continued to be robust as we added 342,000 satellite subscribers in the quarter. More than 80% of our domestic video business is now on DIRECTV platform.

Broadband net subscriber results also were impacted by seasonality as we added 54,000 IP broadband subscribers in the quarter. When you include business subscribers, the company added 74,000 IP broadband subscribers. As we expected, this growth was below recent quarters with second quarter seasonality, but we expect IP broadband net adds to bounce back in the second half of the year.

Now, let's move to our U.S. Mobility results on slide eight. As a reminder, AT&T's domestic Mobility operations are divided between the Business Solutions and Consumer Wireless segments. For comparison purposes, the company is providing supplemental information for its total U.S. wireless operations.

Increasing profitability and a growing subscriber base continues to be the story in our wireless operations. For the second straight quarter, we turned in a record EBITDA margin of 41.4%. Service margins were also a record, reaching nearly 50% in the quarter. Both were up 130 basis points year-over-year. A sharp focus on cost efficiencies and fewer upgrades drove the margin expansion.

Equipment revenues were down due to a year-over-year increase in BYOD subs and a lower upgrade rate. Service revenues increased sequentially but were down year-over-year. At the same time, phone-only ARPU plus Next billing was up 2.5%, with average monthly billings growing to $70. This growth comes even as we see an increasing number of subscribers holding on to their devices longer after completing their scheduled Next payments.

About half of our smartphone base is now on AT&T Next, but 75% of postpaid smartphone subscribers are on a no-device subsidy plan. Postpaid churn came in strong, with its second lowest ever quarter at 0.97%. Postpaid phone-only churn was even lower, and smartphone churn was still lower. And even with the pressures from reseller, our total churn was very low at 1.35%.

Branded phone adds increased in the quarter. Branded domestic phone net adds, both postpaid and prepaid, were up 185,000, thanks to strength in our Cricket brand. We also continued to expand our valuable smartphone base, adding nearly 800,000 domestic-branded smartphones in the quarter. And if you look at the chart on the lower left-hand corner of the slide, you can see that our overall phone base has more subscribers today than we did a year ago, thanks to strength in postpaid and prepaid smartphones. And our postpaid smartphone base by itself is up 1 million in the same time, as feature phones transitioned to smartphones.

We had another solid quarter in adding subscribers. Including our Mexico operations, we added 2.1 million new subscribers. That includes 1.4 million domestic wireless subs with connected devices, branded phones and tablets overcoming losses in reseller largely due to disconnects from our 2G network.

Prepaid net adds in the quarter were impacted by two events. First, we aligned our churn policy across our prepaid platform. This favorable impact was generally offset by the negative impact resulting from a network outage caused by a vendor's equipment.

As noted in our reseller numbers, we're starting to see some churn pressure associated with the planned shutdown of our 2G network at the end of this year. That will increase as we move closer to the shutdown. We'll manage through the process and the cost savings from one less network to support will be meaningful; so will the additional spectrum available to redeploy.

Now, let's look at our international operations. That information is on slide nine. Let's start with Mexico. We continue to make significant progress in building our customer base and deploying our 4G LTE network. We added 742,000 wireless subscribers in the second quarter as we near the 10 million subscriber mark in the country.

Our LTE deployment also was on track. We now serve 65 million people in Mexico with our most advanced network, and expect to reach 75 million by the end of this year. That brings our total North American LTE deployment to 380 million POPs. Our rebranding to AT&T also continues to make progress. We now reach 61 cities with the AT&T brand, including our largest market, Mexico City.

Second-quarter revenue was up 13% sequentially, driven by equipment sales and wholesale revenues. Revenue growth was impacted by lower ARPUs, as the competitive environment has intensified. In Latin America, our DIRECTV operations continue to show revenue growth, up 8% sequentially. Revenues are being hampered by challenging economics, however, we did see subscriber growth, adding 87,000 video customers in the quarter, in part due to the Copa America Soccer Tournament. But as you might expect, the earthquake in Ecuador did pressure our overall subscriber growth in Latin America. But even with these economic conditions, we continued to be profitable and generate positive cash flow from these operations for the quarter.

Now that we're midway through the year, let's take a look at how we are doing relative to the guidance we set out in January. That's on slide 10. We're on track to meet or exceed each of the metrics we have laid out for you. Consolidated revenues are growing at a double-digit pace, thanks to our acquisition of DIRECTV. This comes even with pressure from lower equipment sales and foreign exchange.

Adjusted EPS is up about 7% year-to-date, above guidance, but in line with where we expected to be at this time. Consolidated margins are stable, as margin expansion in our domestic operations is offsetting investment pressure from Mexico. We are focused on growing our valuable subscriber base across our business, including Mexico, where growth has been strong. We are willing to make additional investments to gain quality customers.

Capital investment is trending to the low end of our guidance at its current pace, and we are ahead of plans with free cash flow. Dividend coverage for the first half of the year was 73%. We continue to feel confident that we will meet or beat our free cash flow guidance for the year.

Now, I'd like to spend the remainder of our time providing a strategic update on our business. That begins on slide 12. As Mike mentioned, we have often updated you on our company strategy and direction. But today, we'd like to take a longer look at how we have uniquely positioned AT&T to lead in the rapidly evolving world of communications and video entertainment. Our goal is to be the world's premier integrated communications company, for both consumers and businesses, and we plan to do this in the most cost-efficient way possible.

This strategy did not happen overnight. It has been part of every business decision we've made for many years. No one else has our portfolio of assets. No one else has our cost structure opportunity. And no one else can offer the integrated solutions that we can.

Behind all this is a solid financial foundation that gives us the strength and flexibility to invest in our business while returning value to shareholders. This includes our strong liquidity position, our market-based compensation and benefit plans, and thoughtful debt management.

For example, we successfully negotiated workforce contracts that are market-based but also encourage employees to keep our owners' interest in mind while rewarding them when we succeed for shareholders. We also have a world-class board of directors, who provide great insight while at the same time, challenge us. This makes us stronger and helps us navigate through these transformative times. We are uniquely positioned in this industry. All of this will be critical as mobile broadband, high-speed connectivity and entertainment come together.

Let's first talk about the connectivity building blocks that we have assembled on slide 13. Since the introduction of the first smartphone, we've seen unprecedented growth in mobile data traffic. Even more incredibly, we expect that to continue to grow at a very strong pace. To meet this demand, we undertook several strategic initiatives to improve the capacity of our network for today and the years to come.

Here is what we've accomplished. First, we ratcheted up our investment cycle with Project VIP. This was crucial in getting the high quality, high capacity network we have today. Our 4G LTE network deployment was accelerated – fiber backhauled, deployed, and cell sites built. We now have almost 70,000 cell sites, thousands more than our largest competitor and our move into the Mexico wireless market further expands our LTE reach. We also drove fiber deeper in our wireline network. We added more than one

1 million business locations to our fiber network and we expanded our IP broadband footprint to more than 60 million customer locations.

The next phase of driving fiber into our network is our GigaPower deployment. Over the next few years, we expect to reach at least 12.5 million customer locations with our gigabit broadband service. We now have more than 2.2 million fiber-to-the-home customer locations and we expect to reach 2.6 million or more by the end of the year. Our already dense wireless network and expanding fiber footprint puts us in an excellent position as we move to more small cells and 5G. We've already filed patents. Trials are already underway, and testing is ongoing. When 5G is ready to roll, we will be ready as well.

At the same time we launched VIP, we moved to expand our spectrum portfolio. We have about 150 MHz of spectrum in our portfolio today, including 40 MHz of relatively untapped AWS and WCS spectrum. We have the best, most balanced spectrum portfolio in the industry. Adding spectrum is the most effective way to add capacity. This year, we expect to add 35,000 LTE carriers compared to the 18,000 deployed last year. We also continue to make smaller spectrum deals to round out our coverage and redeploy spectrum once dedicated to 2G and 3G.

Last week's move by the FCC to make high-frequency radio spectrum available for 5G wireless service is another step forward, providing us more spectrum. And while we are not going to elaborate, AT&T has applied to be a participant in the broadcast spectrum auction and has also submitted a bid in the FirstNet process that is currently underway.

Our network transformation is now pivoting to software-defined networking or SDN. With SDN, we are virtualizing network functions that used to require dedicated fixed equipment and software. SDN gives us flexible, dynamic and smart network capabilities. We ended last year with about 5% of our network functions virtualized and expect to reach 30% by the end of this year. We are on path to achieve 75% network virtualization by 2020. SDN also provides cost savings, which supports our drive to an industry-leading cost structure. Let's discuss that on slide 14.

Having an industry leading cost structure helps us expand margins and grow free cash flow. We now have a line of sight to continue margin improvement as well as reaching our goal of $20 billion in free cash flow. This is what we need to do to reach those goals. Step one, is achieving the cost synergies from our DIRECTV acquisition. We are on track to achieve $1.5 billion-plus run rate synergies with DTV by the end of this year. That puts us well on our way to hit our projected $2.5 billion-plus run rate savings by the end of 2018.

Step two is our work to drive efficiencies with Project Agile. This work includes our efforts to serve customers digitally, automating service delivery, streamlining operations, and other cost efficiency initiatives. Our goal is to generate a $3 billion run rate in cost savings and we are moving past the midway point of making that happen. We also have not been shy about exiting non-strategic businesses that don't fit our margin expansion profile. That includes global hubbing, and more recently, certain hosting operations. Obviously, that reduces revenue but increases overall profitability.

Finally, we must continue to lead the industry in our move to software-defined networking. We are virtualizing functions that previously required dedicated solutions, dedicated hardware, dedicated software, dedicated teams. This virtualization manifests itself into real sustained cost-savings throughout the network and the business. That's savings in both our capital expenditures and our cash operating expenses. It also gives customers greater control of their network services, more agility and simplicity in the way they do business with us, as well as better value on ours and our customers' hardware investments.

Now, let's look at something that really separates us from the rest of the industry – our integrated solutions approach. That's on slide 15. While it starts with connectivity, and cannot be sustained without an effective cost structure, you must have assets to create products customers want, delivered where and how they want them to be successful.

We've talked about these assets, but let's bring this point home. We are in every major market in the U.S. with reach around the world. We have a 4G LTE footprint that covers 380 million people in North America. We have more fiber connecting more buildings and more business customer locations than anyone else – that's in footprint and out – which helps us compete today but also positions us very were for 5G. And we're also the biggest TV provider in the world, and we're about to introduce an over-the-top product that we believe will be a game changer. DIRECTV now is scheduled to launch later this year, and we expect the millions of people who don't now subscribe to a video service and prefer a streaming option will be impressed.

At the same time, no one can match what we offer business customers. We have the ability to serve all business customers, from Fortune 1000 companies to the local ice cream shop on the corner. And no matter how big or how small the business is, almost every conversation with business customers begins with mobility and security, and that is where we excel. When you take our extensive fiber network, then layer on SDN, security and mobility, and new software-enabled services, you have the premier integrated business services company.

We believe we have a significant competitive advantage to use our connectivity and cost structure to offer integrated solutions to our customers. Whether you are in the C-suite of a major company to the master suite of your own home, and anywhere between, AT&T delivers. We have a robust, dynamic, and attractive set of products architected on a network that is flexible and able to quickly adapt to the future. That's table stakes if you want to be the world's premier integrated communications company, and that is exactly what we expect to be.

Now before we get your questions, allow me to quickly summarize, and that's on slide 16. We are very confident in our unique strategy. We have the assets we need and we are executing on our plan. Our DIRECTV cost synergies are hitting the targets. Project Agile is on track. And we are ahead in the move to software-defined networks. All this drives us towards an industry-leading cost structure.

But we're most excited about what lies ahead. We have a dedicated and skilled group of people working for us. From the crews staffing our work centers to leaders in the boardroom, we have a team of professionals focused on making AT&T the world's premier integrated communications company. Our differentiated position opens the door for some game-changing opportunities, and we're ready to walk through it. We're confident we can execute on our strategy and continue to build value for our shareholders. With that, let's go to your questions.

Question-and-Answer Session

Operator

Thank you. Our first question will come from David Barden with Bank of America. Go ahead, please.

David William Barden - Bank of America Merrill Lynch International Ltd.

Hey, guys. Thanks so much for taking the questions. John, it looks like, in terms of the guidance as you kind of walk through it on slide 10, you're kind of tracking ahead of where you thought you'd be at this point in the year. As we look to the second half, could you talk about the major variables that would kind of maybe swing you back down towards more the base case expectation for the year versus the – or better part of the guidance that you were discussing?

And then second, I was wondering if we could just touch on this issue of kind of the economics of postpaid sub losses versus prepaid sub gains. I guess you had about 319,000 prepaid gains versus 180,000 postpaid losses. Could you talk about the relative economics of those two things? And are we looking at a net economic positive or negative trade-off when we look at that? Thanks.

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

Thanks. Thanks, David. Let me take the second question first. On the economics, so forth, the postpaid subs were losing a lot of feature phones. They're averaging about somewhere around $35, maybe a little bit less, than ARPU, and have costs associated – the postpaid do – with retaining them. On the prepaid side, we're probably closer to a $41, $42, depending upon the specifics, average ARPU, and much less – they're very, very small subscriber acquisition costs, upfront costs, maintenance costs by the very nature of being prepaid.

So from that standpoint, the economics are better, and it is being shown in our margins. When you look at our margins – total EBITDA margins or service margins – you can see that growth, and you can see the level. That's a part of what's driving it. So the economics are – and we're running the business on a branded basis – we think of branded customers and try not to make distinctions on classification. Really makes distinctions on economics, and I think it's showing up in our profitability.

With regard to the variables in the second half, there's a lot of things that happen in the second half. There's some seasonality in the fourth quarter in our wireless business. In our video business, we'll have the NFL Ticket come out and we'll have the launching of the DTV Now, and some of the over the top offers. So we'll have a whole host of things going on. I would just suggest to you we're very confident where we're at. We continue to do well. And I wouldn't suggest to you that there's anything necessarily unique or different about the second half of the year. It's just we're careful with our guidance and want to make sure we meet or exceed it; so we feel very good about we're at through six months.

David William Barden - Bank of America Merrill Lynch International Ltd.

All right. Thanks, John.

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

Thank you.

Operator

Our next question will come from Phil Cusick with JPMorgan. Go ahead, please. Mr. Cusick, is your phone on mute?

Philip A. Cusick - JPMorgan Securities LLC

Can you hear me, guys?

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

We can, Phil.

Philip A. Cusick - JPMorgan Securities LLC

Thanks very much. So, a little bit along the lines of David's second question, when would you expect we'd see more integrated promotions for video and mobile services? And you've talked in the past about having some excess margin to give up to drive faster sub growth. Do you feel like you've been doing that already or is that still pending? Thanks.

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

Thanks, Phil. So first of all, we have been doing some promotion, some offers, some marketplace adjustments based on how we look at the marketplace. So, some of that is already impacting our results, and we're still doing quite, quite well in margins with that. Secondly, our first integrated product, I'd refer you to is the 5 million customers who have already signed up who have a bundle of our in-home video product, whether it be U-verse or satellite – DIRECTV satellite – and our wireless. It's been successful. We've seen very positive results from our customers, so it is going well. You will see us continue to push that offering as well as others.

And then, I would suggest to you you'll see more things come out as we roll out our over-the-top offerings and other aspects. But right now, we are seeing some improvement in our attach rate of IP broadband with our video sales. And that is improving as we see the trends for the last four or five months. And we would expect to see some continued positive bundling, if you will, of wireless and video, as we've already seen 5 million people sign up for it.

Philip A. Cusick - JPMorgan Securities LLC

John, you mentioned DIRECTV Now. What's the long pole for getting that out at this point?

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

I think there is a whole host of activities going on. I would suggest to you it's this way. While I believe that everything is moving well and all on our timeline that we've targeted, the biggest guidance piece on it is going to be, we're going to want to make sure it comes out with high quality and high performance. And so, as we develop this and test it, that will determine its timeframe. We'll want to make sure when it comes out, it's the high-quality product.

If you think about the technology development, that's on track. If you think about the assets we need to provide that, those have been acquired; those are on track. If you think about the contracts we need to get the stacking rights and digital rights, those are going well. It's just a matter of getting all of those things coordinated together and then make sure it's the highest quality product you can have at launch. But we are confident in that process, and feel good about targeting the end of this year to get that out.

Philip A. Cusick - JPMorgan Securities LLC

Do you have a widespread beta product of that yet, even without all the content?

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

Yeah, we are going through various levels of testing of everything, but we're not going through a detailed public discussion of that. But as you can imagine, we're going through a variety of levels of testing of that. But this is something we've been working on for a while – feel real good about.

Philip A. Cusick - JPMorgan Securities LLC

Thanks, John.

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

Sure.

Operator

Thank you. Our next question comes from John Hodulik with UBS. Please go ahead.

John Christopher Hodulik - UBS Securities LLC

Great, thanks. John, maybe pointing to the build-up of the $20 billion free cash flow number on slide 14, it looks like you're at about a $16 billion base in 2016 here. You've got another $1.0 billion in synergies and another $1.5 billion in Project Agile. Is the rest – come from virtualization over that period? If you could give us a little more detail on that, and I would imagine you'll be paying some more taxes over time as well. So, how does it all fit together to sort of bridge us to that $20 billion number?

And then, as you talked about in the – some previous slides, you're a little bit – you've underspent the $22 billion bogey on CapEx a little bit here in the first half. Does that mean there's – we have a sort of downward bias to CapEx at this point? Thanks.

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

Thanks, John. A couple of things. One, if you think about the free cash flow and you think about the $15.9 billion that we started with last year, and you add in the kind of the $2.5 billion dollar opportunity with DIRECTV. You add in the – with the remainder of the $3 billion opportunity from Agile. And then you add in maybe a 1%, I'll say is an illustrative, reduction in capital intensity and some costs – some cash operating expense savings – you can see that those three items there can get you well over $5 billion.

In addition, we expect to grow our EBITDA and grow our profitability of the business. And so, when you put those things together, it looks to be an achievable, real, realistic path from last year's $15.9 billion to a $20 billion number as a goal in the near future. And so, that's what we are looking at. That's how we build it up. We're not giving a prediction date on that, but we feel good about the opportunities to significantly grow free cash flow.

With regard to our CapEx, just want to be very straightforward in the sense that we are at $10.3 billion, and on an annualized basis, that would come below the $22 billion. We will continue, as I've said before, to invest as appropriate, not towards a targeted $22 billion number, but rather towards a, what business cases make sense, and when it makes sense for us to be in the market investing. Sometimes that causes quarters to be much heavier in CapEx, like we had in the fourth quarter last year. And other times, like in the first six months this year, we spend at a lower rate. We're just being very careful with every dollar. But right now, the performance we've had for the first six months is a trend to – on the low end of our guidance.

John Christopher Hodulik - UBS Securities LLC

Okay, great. Thanks.

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

Sure.

Operator

Thank you. We now have a question from Mike McCormack with Jefferies. Go ahead, please.

Mike L. McCormack - Jefferies LLC

Hey, thanks. Hey, John, just maybe a couple of things. First, going back a little bit on the postpaid handset side. It looks like – obviously, feature phones have come down dramatically over the past eight quarters or so. As that sort of approaches a lower level, does that provide a tailwind to get postpaid phone additions back to a positive territory? And obviously, you've got DTV cross-selling, DTV Now products rolling out, or over-the-top products rolling out. I presume that could also help. And then, just secondly on the video adds for the year, the anticipation there, is it that DIRECTV continues to ramp? You've been doing a great job, but is it that or is it U-verse becoming less of a headwind in the back half of the year to get to a positive video number?

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

Thanks, Mike. First of all, on the postpaid handset side – or on the handset side – we do think the 2G losses, as we go through the year, we'll see those. But getting past this year, you'll see the opportunity to have a more positive impact because we're through that process. Secondly, our feature phones, which include some 2G devices, but our feature phones are going down and as they go down and that, if you will, legacy product, so to speak, impact on our results is lessened, certainly we have a brighter opportunity – a better opportunity to grow out of those customer base.

And then third, on the bundling, as we really get into the second half of the year and are able to do single-truck install, which may be bundling of video and satellite and broadband, but also, that whole activity of bundling, the more time our teams get to do it, the better we'll get at it. And so from that perspective, we do think that'll provide us an opportunity to grow more wireless.

So all three of those things will help, and yes, we're optimistic about it. But I will tell you also, it's really about the branded net adds and the economic net adds. It's not about any one category of net adds. It's getting those customers that are the most profitable, the highest quality.

With regard to the video side, on a seasonality basis, we usually do see less. We see more pressure in the second quarter than the first half from the U-verse side. And from, and quite frankly, so has DTV in the past. So going forward, I would hope that we would see – we'd expect to see – some improvement on both sides. When you think about DIRECTV, things like the NFL Ticket Sunday, and some of the other offers, as we see these trends of bundling improving an attachment rates improving, we feel really good about the opportunity to improve our trends and get to our goal of positive video net adds for the year.

Mike L. McCormack - Jefferies LLC

Great. Thanks, John.

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

Thanks.

Operator

Thank you. We have a question from Amir Rozwadowski with Barclays. Please go ahead.

Amir Rozwadowski - Barclays Capital, Inc.

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

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

Hi, Amir. How are you?

Michael J. Viola - Senior Vice President-Investor Relations

Hey, Amir.

Amir Rozwadowski - Barclays Capital, Inc.

Good. John, so if we can touch upon that bundling question a bit more. If we go back to last year at the analyst update, post the close of the DIRECTV deal, you had highlighted some potential areas for revenue synergies driven by some level of cross-pollination of your respective customer bases. And I was wondering, where are you folks along that line? You had highlighted like there were, I believe, 15 million DIRECTV homes that don't have AT&T wireless, for example. Other opportunities seemed to be broadband plus video offering. Are you still at the early stages of that deployment? I'm just trying to assess, sort of, what kind of runway you do expect from a bundling opportunity perspective?

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

Yeah, Amir, I would suggest we're at the early stages when you think about getting the workforce trained in all aspects of being able to cross-sell and do the bundling in the cross – and do single-truck roll installs and so forth – it takes a while. We have that completed; we have that process. But even as they all have been trained and they've all started to do it, it still takes some time – even with the great workforce like we have – to get really proficient at it. And we'd expect to start seeing that, as we've said all along, show some benefits in the second half of this year.

But once again, I would suggest to you, the team's done a really good job of doing the bundling between wireless and the video products alone. And getting 5 million of these customers to sign up for this bundled approach with regard to video and wireless, is just the best proof I can offer you that we've already done, they've already accomplished, that this works and that we have a real opportunity to exceed our merger integration synergies because we'll have an opportunity to add revenues to those. Well, most of those synergies were really focused on costs.

Amir Rozwadowski - Barclays Capital, Inc.

That's very helpful. And a follow-up, if I may. If we look at the current U.S. mobile competitive environment, one of your competitors notably instituted a price increase, which can somewhat imply a belief that the competitive landscape is not as pronounced as it once was. If we look at your service revenue trajectory in mobile, we still see some impact from stable declines in ARPU. Is there potential opportunity for adjusting pricing, particularly around bundled offerings or anything along those lines that could provide some relief to the trajectory of service revenue there?

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

Well, Amir, once again, let me point you to kind of a complete picture of that. As we mentioned in the prepared remarks, the ARPU's right at $70 on a per-customer basis when you take into account the total billings. Those are really impressive levels, very good for us historically from any measurement – our straight ARPU prior to the equipment installment days, or in the most recent years, with the equipment installment. So, on a monthly basis from our customers, we're doing very, very well with the revenue base.

Secondly, it is a competitive environment, and it will – and it has been for years – and it will remain that. We believe that we are doing well with that, and we think it's proven out in our margins, in our profitability, and in our cash flows.

I will tell you just one side item that we mentioned in the prepared remarks. We had about 500,000 BYOD devices. We had customers walk in with 500,000 phones and said, can we connect them to your network? Those are all net adds. They don't show up in equipment revenue. And depending upon what package they show up, they'll show up in service revenues. But they are really profitable. They're low cost. We love them. That doesn't necessarily show up in your immediate look at the financials, but it is clearly showing up in our profitability and our margins. So, I would ask you to focus on those items as well as our service revenues.

Specifically with regard to our service revenues, you've seen our additional piece of our customer base shift to Mobile Share Value. I think we went from about 64% up to 75%. We did have some additional customers shift off of the – shift to the no-subsidy plans – which impacted service revenues. And we continue to do normal promotions through some of the incentives, credits, free services – normal promotion activity. All of those things are impacting service revenues as expected.

With regard to recent activities in the marketplace, we'll see how those play out. We're just focused on getting the best quality customers and providing really great service. Some of the changes we've seen give us reason for optimism. Many of the changes we've seen give us reasons to be real careful and watch how the market develops, and be ready to prepare and lead, quite frankly, in a market with the performance that we've got.

Amir Rozwadowski - Barclays Capital, Inc.

Great. Thanks for the incremental color.

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

Thank you.

Operator

Thank you. And we'll go now to Jeff Kvaal with Nomura. Please go ahead.

Jeffrey Kvaal - Nomura Securities International, Inc.

Yes. Thanks very much. I'd also like to add a competitive question to the mix. Typically, of course, the second half, the fourth quarter, a little bit more competitive. Do you feel like you are going to be as competitive as you've been last year? Is the goal to increase the number or the mix of net adds that you retain relative to where you've been over the past couple years? Just in general, how you feel about your subscriber base and your mix of net adds would be great.

And then, secondarily, if there's anything then you can share on where in your CapEx budget you have been able to do better, whether it's labor or equipment or what have you, that would be super helpful. Thank you.

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

Okay. Well, the second one first. On the CapEx budget, we've done well, kind of in all aspects of it. A couple of things. One, we've been able to – because of our software-defined network – we're starting to see a little bit of those savings. If you think about our buying capacity and the overall economic conditions, we've been able to get some volume pricing and some purchasing power benefits. Certainly, we're getting more efficient with what we do.

I will tell you, though, that one of the things I think people miss out on is that because of the spectrum that we've invested in over the last, say, five years or so, we've got a lot of effective capital deployment that doesn't involve a lot of dollars. It involves deploying spectrum, and that's a really efficient way to deploy capacity. And so, on a per-unit of capacity, our dollars can be really efficient because of the spectrum portfolio that we have that we're putting in use. I think that's a real big benefit.

From a customer base perspective, we're very pleased with the subscriber base we have, whether it's the business subscriber base that we have, what we saw in the small business side and the growth there, whether we see it in the enterprise side. When you look at the consumer side, the prepaid business is growing well, and quite frankly, the margin improvement from Cricket is helping drive the margin improvement in the overall business of wireless. So, that's great. And then of course, some of the premier customers in the video space are using our U-verse and our DTV services.

So, we feel great about our customer base. With regard to that, we're willing to invest dollars to retain and attract additional quality customers, whether here in the United States or in Mexico and Latin America. We'll be focused on that but we'll be careful with it. I would suggest to you the characteristics – the titles we give those prepaid, postpaid, over the top versus monthly subscription – are less important as the economics of the profitability of those offers. And that's what we'll be focused on.

Jeffrey Kvaal - Nomura Securities International, Inc.

Okay, John. So that sounds like you are perhaps expanding the range of subscribers that you might defend or target than you might have – than relative to last year. If that makes sense.

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

Well, I'll say it this way. When your margins expand as much as ours have – about 130 basis points in both EBITDA service and, for example, in wireless, or in total margins – you have more room and more customers fall within that profitability level that are appropriate.

Jeffrey Kvaal - Nomura Securities International, Inc.

That's well said. Thank you.

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

Yeah. That's really what's going on. The team's done such a great job expanding margins, they've created more room to be competitive. It's the team's credit.

Operator

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

Brett Feldman - Goldman Sachs & Co.

Thanks. John, you noted that you're on track to deploy fiber to 12.5 million customer locations. You have 12.6 million IP broadband customers today, but there are 60 million homes in your wireline region that could get a broadband line. So I'm curious, as you're doing the fiber deployment, how are you deciding which are the right homes to upgrade in terms of whether you should simply upgrading existing customers or how do you determine whether it's a business case to go to some of those homes that you don't serve and deploy fiber there?

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

There's two things that – I mean, the first thing I'd tell you, Brett – is that the ability to build the fiber to the home is a larger footprint than just the 60 million. So we can take the economics of going into some appropriate customer basis, whether it's an opportunity for real – better economics, better profitability. So, we have that kind of business-case process to it.

Secondly, I would tell you that with regard to the FCC agreement, there's particulars within the agreement that allow us to build – count so many greenfield builds, count so many more upgrades in the existing IP broadband footprint – to utilize in some cases multiple dwelling units, and then in many cases require some level, or a significant level I should say, of new builds. So, we have to coordinate all of that, take all of that into consideration. When you're done with that, you may still have some profitable builds that are at or above the 12.5 million commitment and you may go ahead and build those. We'll see where that goes over time and we'll see where that leads us.

But the ability or the schedule to build is an economics activity, a business-case activity with, of course, the opportunity to over-build in some areas being probably more timely and less expensive. But that might be capped by some of the regulatory agreements that we have in place, and we're going to certainly be respectful of those. But overall, it's kind of a normal business-case process and where we can serve our customers the best and get the best returns for them and us.

Brett Feldman - Goldman Sachs & Co.

Got it. And just as a follow-up to make sure I heard that right, I think you said that you are considering taking fiber outside of your traditional wireline region if the business case makes sense. Is that – did I hear that correctly?

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

We've already done it. We've already done that in many cities. So, I don't want to suggest to you that we haven't.

Brett Feldman - Goldman Sachs & Co.

How do you pick those markets? Are these places where maybe you've already done a lot of fiber for your LT networks so it's a natural extension or are there other characteristics that tend to be appealing?

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

Just customer characteristics, competitive situation, access to other facilities we might have, a whole collection of considerations, whether it's a technology corridor like Raleigh-Durham or other such considerations. But that's a normal business-case process for us.

Brett Feldman - Goldman Sachs & Co.

Okay, got it. Thanks for taking the question.

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

Sure.

Operator

Okay. Thank you. Our next question is from Simon Flannery with Morgan Stanley. Go ahead, please.

Simon Flannery - Morgan Stanley & Co. LLC

Thanks a lot. Good evening, John. So, going back to the presentation a year ago, one of the things that you said you were working on was a home media gateway. And I know there's a bit of product development in that, but perhaps you could just update us on how that's looking, when we might start to see that getting deployed?

And then there's a lot going on in Washington and obviously you can't talk about the auction, but maybe you could just give us some of your perspective on some of the agenda items at the FCC around special access, set-top boxes, privacy, et cetera, and any exposure you see there? Thanks.

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

Yeah. So set-top boxes, we have commented on that – the industry's commented – and there's been significant support, I think, from Congress on that. So, I think that we would expect, we would hope – we've seen the people coalesce and we'll see some changes into what the initial FCC guidance was on that.

On the special access piece, we think there's competition across the marketplace today. We see it and we would think that any kind of additional regulation of products that are already competitive will stifle investment and won't be good for consumers or businesses or the overall economy; so we think that's, if you will, headed in the wrong direction. We'll continue to present our case on that.

On Title II, we always expected the final resolution to be in the hands of the Supreme Court and we'll work through the process and follow the Supreme Court process closely, and then make our decisions going from then on. I would suggest to you those are really, kind of my comments on all of those matters.

With regard to assignment of the home media gateway, I'd suggest to you this aspect, that we continue – and I'm not going to be able to give you a detailed answer, I'm not going to try to, on a home media gateway. But what I will tell you is that we continue to believe that as we go through the process we can get cost synergies in DTV by standardizing the interfaces, whether they get the video over the satellite, whether they get it over the broadband or whether they get it over the IP television. And we continue to work on those activities, to standardize the graphic use interface, the set-top boxes and what you, what many would consider a gateway or a home gateway, for media. Those activities continue to be on and we'll continue to work for that. It's a natural efficiency and it's also a really good quality service for the customers.

Simon Flannery - Morgan Stanley & Co. LLC

Okay. It sounds like that's a sort of, still a medium-term item?

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

Yes. I would not suggest it's a near term item. I'd have to be honest. And I will go back with my team and follow-up on that, but right now I would suggest it's a medium-term.

Simon Flannery - Morgan Stanley & Co. LLC

Great. Thank you.

Michael J. Viola - Senior Vice President-Investor Relations

Hey, Kathy, we'll take one more question.

Operator

Thank you. Then the final question will come from Tim Horan with Oppenheimer. Go ahead, please.

Timothy Horan - Oppenheimer & Co., Inc. (Broker)

Thanks, guys. Two quick ones, if you don't mind. John, can you give us a sense of what your services-only ARPU is, or if I bring my own device, what that is? Because I know my own children, they've been blowing through their data usage since they got out of school and that's a lot of new applications out there. Can you maybe talk about how much the current data volume growth can drive ARPU growth, in your opinion, over the next few years? And then I just had a quick clarification.

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

Yeah. So Tim, certainly we are seeing buckets get bigger for our customers. We are seeing their demand so we're optimistic about that opportunity. We're careful about it because of the competitive environment and responding to, or at least understanding how competitors may respond to what we've done. So certainly, the data growth, as we spelled out in our slides, the data growth continues, and for us, as an integrated carrier with the backhaul and the fiber and the extensive number of towers and spectrum, we feel really good about our competitive position.

The question of how quickly we can get our data growth, or at what percentage that will be, will be a function of both the efficiencies we're putting into our data delivery as well as customer demand and competitor pricing. But, yes, there is absolutely a lot of growth in demand and usage, and we hope to capture that in additional revenues as we go forward.

Timothy Horan - Oppenheimer & Co., Inc. (Broker)

Great, and I think John Hodulik said you were halfway through your DTV synergies and Project Agile. Is that correct?

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

We're on track to get to the $1.5 billion – we say $1.5 billion-plus – run rate by December this year. So I don't want to suggest to you that that's the number for the year. It's the run rate at that level.

We'll get to it in December, and so we feel really good about where we're going for next year and the year after. And getting to the $2.5 billion run rate in 2018 is our guidance, so that's that piece of it. We are on track to get about half of those Project Agile savings today. That is correct, and we said that in the prepared – that'll be in the script. That's in the prepared remarks.

Timothy Horan - Oppenheimer & Co., Inc. (Broker)

Great. Thanks a lot.

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

Sure.

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

With that, I want to thank everybody for being on the call today, and let me just give you a few closing comments before we go. It's been one year after our acquisition of DIRECTV and we are very pleased with where we stand. The integration of DIRECTV is on track. Cost synergies are ahead of target, and we've added nearly one million satellite customer since the merger. And our new streaming services are scheduled to come online later this year.

We believe our unique assets, our leading cost structure and our ability to offer integrated solutions positions us like no one else. We think this is just the beginning. We are positioned as a unique competitor and the first scaled communications and video provider to offer fully integrated nationwide products, and we fully expect to increase our momentum as we go forward.

As always, on your way home tonight, remember: When it comes to texting and driving, it can wait. Thanks again for being on the call, and as always, thank you for your interest in AT&T and have a good evening. Good night.