Operator

Ladies and gentlemen, thank you for standing by, and welcome to the AT&T Fourth Quarter 2011 Earnings Release. [Operator Instructions] As a reminder, today's call is being recorded.

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

Brooks McCorcle

Thanks, John. Good morning, everyone. Welcome to our fourth 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 on the call joining me this morning are Randall Stephenson, AT&T's Chairman and Chief Executive Officer; and John Stephens, AT&T's Chief Financial Officer. Randall will provide opening comments, then John will cover our results, and then we'll follow with Qs & As.

Let me remind you that our earnings material is available in the Investor Relations page of the AT&T website. As a reminder, that is www.att.com/investor.relations.

I also need to reference our Safe Harbor statement, which is on Slide 3, and that says that this presentation and comments may contain forward-looking statements. They're subject to risks, and details are in our SEC filings and on AT&T's website.

With that, I will now turn the call over to AT&T's Chairman and Chief Executive Officer, Randall Stephenson. Randall?

Randall L. Stephenson

Thanks, Brooks. Good morning, everybody. I'll start with just a couple of brief comments on 2011, then what I want to do is just move into our plans and outlook for 2012. And 2011 was obviously an eventful year not only for us but the entire industry, and what I hope didn't get lost in all the news cycles on mergers and iPhones is what AT&T accomplished during the course of the year and really how that positioned us for 2012.

We came out of 2011 with each of our key growth platforms, mobile broadband, strategic business services and U-verse, all growing at strong double digits. That means better than 3/4 of our total revenues now come from wireless data and managed services and those have a combined growth rate above 7%. We had really strong mobile sales throughout the year. In fact, we had a blowout holiday season. And in the fourth quarter, we sold 9.4 million smartphones, that's 50% above our previous record.

In the year, when our competitors began selling the iPhone, we outsold them in every single quarter. We also led all competitors in total wireless subs added, 7.7 million for the year. And we're #1 in just about every key mobile broadband growth metric: smartphones, emerging devices, postpaid data ARPU and customers on tiered pricing plans.

And when you look at the network side of the equation, this was, for us, an unprecedented year. We challenged our network team to push call retainability on our 3G network above 99% by year end, and we've now hit or beat that 3 months running. We closed the year with 80% of our total mobile data traffic on Ethernet backhaul. That's well ahead of our original plan. And we're pleased to have that deployment behind us because we believe we now have the most robust backhaul infrastructure in the industry. And this is a backhaul infrastructure that is built for data.

On top of this infrastructure and on our HSPA+ platform, we're now deploying 4G LTE. And today, we have the best data speeds in the country. The iPhone 4S on our network has download speeds that are 3x our peers.

In wireline, our U-verse build is now largely complete, so we have in place an IP video and broadband platform that reaches 30 million customer locations, which gives us significant headroom now to drive penetration.

On the business side of the equation, despite the economy, we've executed a very steady climb in revenue trends. We're now 2 straight quarters of sequential increases and we have line of sight to year-over-year growth this year. And we continue to be very, very strong in terms of cash generation capabilities on operations, better than $34 billion for the year.

So with these data points, I'd like to -- I like how we're set up for 2012. And as we sit here in January, I'd tell you, we probably have the best visibility going forward than we've had in quite some time. John is going to cover the outlook in detail, but at a very high level, here is what you ought to expect from us as we go into 2012.

We're going to continue to be very aggressive in growing our mobile broadband franchise. We'll return to revenue growth in our business segments. We'll expand wireless and consolidated margins. We'll achieve mid-single-digit EPS growth or better. Cash generation continues to look very strong again next year. And given the operational momentum we have in the business, all of this appears very achievable and probably at the conservative end of our expectations.

I'd add that this outlook is not dependent on any kind of boost from the economy. Holiday sales suggest there's a possibility for some light tailwinds and we're hopeful for that, but all the core fundamentals suggest we're looking at continued slow U.S. economic growth and then higher unemployment so we built our plans around a fairly low growth scenario.

As we look ahead, the issue that gives me the most concern, quite frankly, isn't our ability to execute. The #1 issue for us as we move forward, and for the industry, I believe, it continues to be spectrum. This industry continues to see just explosive mobile broadband growth and is providing one of the few bright spots in the U.S. economy, but I think we all understand this growth cannot continue without more spectrum being cleared and brought to market. And despite all the speeches from the FCC, we're all still waiting.

The last significant spectrum auction was nearly 5 years ago now. And this FCC has made it abundantly clear that they'll not allow significant M&A to help bridge their delays in freeing up new spectrum. So in the absence of auctions, our company and others in the industry have taken the logical step of entering into smaller transactions to acquire the spectrum we need to meet this demand. But even here, we need the FCC's action and leadership, and unfortunately, even the smallest and most routine spectrum deals are receiving intense scrutiny from this FCC, oftentimes taking up to a year and sometimes longer before these are approved.

Now I hope I'm wrong, but it appears the FCC is intent on picking winners and losers rather than letting these markets work. A lot of recent comments and speeches about certain members of this FCC suggest that they and not Congress should decide how spectrum auctions are conducted, including who can participate and what the conditions should be for participating. Meanwhile, we pile more and more regulatory uncertainty on top of an industry that is a foundation for a lot of today's innovation, making it difficult for all of us to allocate and commit capital. And in this industry, we all know capital investment equals jobs. So the end result of this is we have a industry that is just really stuck in terms of creating real capacity.

We will certainly do our part, as we move forward, to provide leadership on these issues, but it's also clearly time for Congress and the FCC to step up. And in the interim, this environment has a lot of clear implications for our business and these are in 3 different areas. First, while our current overall spectrum position is competitive, we've led the way in mobile data. Therefore, our utilization rates are running very hot and demand continues to accelerate so we'll continue to do a number of things. In a capacity-constrained environment, usage-based data plans, increased pricing, managing the speeds of the highest volume users, these are all logical and necessary steps to manage utilization.

LTE deployment is also going to play a role. We ended 2011 with 74 million LTE POPs covered and we'll accelerate that pace considerably in 2012. This setting us up to complete our deployment to 80% of the U.S. population in 2013. And LTE does give us a 30% to 40% lift in network efficiency, but at current growth rates, that equates to only about a year's increase in traffic, so while LTE is important, it's not the silver bullet in terms of capacity planning. What that means is, to meet customer demand, we have to continue our push to add spectrum in the open market. You'll see us being active there and we'll continue to advocate for more open auctions as soon as possible.

And then second, in this environment, we'll accelerate our efforts to improve our overall growth profile. We'll do that by looking at opportunities to either divest or restructure low-performing and nonstrategic assets. You've seen us do this in the last year or two with our Sterling Commerce sale and the restructure of our Telmex holdings. And you'll see more of these actions over the next 24 months.

And third, given the economic and regulatory situation, it makes sense for us to begin to resume our share repurchase plan. We currently have a 300 million share authorization, that's about 5% of our shares outstanding, and we'll begin to execute on that immediately. And as we go through the year, our Board will likely evaluate further actions.

So our cash flow's strong, the balance sheet is rock solid. We reduced total debt by $6.5 billion in the fourth quarter alone and this gives us a lot of flexibility and a lot of capacity to return value to our owners.

And so with that, I'm going to turn it over to John to cover results and I'll stick around for Q&A. So, John?

John Joseph Stephens

Thank you, Randall, and good morning, everyone. Let me begin by providing consolidated financial summary, which is on Slide 6.

2011 was a story of record mobile broadband sales and solid revenue gains. Revenues were up 2% for the year and 3.6% in the fourth quarter alone. Stronger-than-expected smartphone sales also impacted earnings and margins.

In the fourth quarter, we reported earnings per share of a negative $1.12. Excluding $1.54 of mainly noncash onetime items, earnings per share for the fourth quarter was $0.42. Onetime items included $0.65 of noncash pressure from the year-end mark-to-market change for our benefit plans. The actuarial loss on benefit plans was driven by a reduction in the discount rate from 5.8% to 5.3%. While our investment returns were better than the overall market, they were less than our expectations but that was largely offset by better-than-expected force retention and medical cost management. $0.48 of the noncash pressure is due to asset impairments in our yellow page and directory operations. This was part of an annual review in tangible assets, comparing them to fair market values of similarly situated companies. $0.44 of pressure is due to the previously-announced termination of the T-Mobile USA transaction, and we have $0.03 of help from a tax settlement.

Cash flow continues to be strong: $2 billion in the quarter and $14.4 billion for the year. And when you adjust out the onetime contract termination payment, it was outstanding. Looking ahead to 2012, we expect earnings to grow in the mid-single digits or better for the year.

Now let's look at revenue growth and how our growth drivers are transforming our revenue mix. Details are on Slide 7.

Fourth quarter consolidated revenues totaled $32.5 billion, up 3.6%. For the year, consolidated revenues grew by almost $2.5 billion. The growth drivers were strong mobile broadband results, very good U-verse gains and continued strength in strategic business services. In 2011, 76% of our revenues came from wireless and wireline data and managed services. That's up from 68% or more than $10 billion from just 2 years ago. And revenues from these areas grew about $7 billion last year or more than 7% for 2011. We're confident this mix shift will continue. In fact, in 2012 we expect consolidated revenues to continue to grow, thanks to strength in these growth drivers with little expected lift from the economy.

Now let's take a look at wireless on Slide 8. Our mobility sales channel did an outstanding job, delivering not only the best sales quarter in our history but the best smartphone sales quarter in the history of the industry. We added more than 2.5 million subscribers. This includes gains in every customer category. Postpaid net adds were terrific, with our best performance in 5 quarters, adding 717,000 subscribers. Tablets drove prepaid net adds. Reseller sales continued to be strong, and we had another million-plus quarter with connected devices. We did see churn increase slightly, only 6 basis points for the postpaid side during what we view as the most competitive quarter of the year.

Strong smartphone sales also drove impressive revenue growth. Total wireless revenues were up $1.5 billion or 10% and wireless service revenues increased by $0.5 billion. We grew postpaid ARPU, as we have done for every quarter for the last 3 years. We also grew it from a much higher base than anyone else. Our postpaid ARPU is $6 higher than our closest competitor. And in 2012, we expect postpaid ARPU to continue to grow and to grow 2% for the year, thanks in part to new pricing plans that we announced last week.

We also continue to bring more subscribers onto our network with tiered data plans, more than 22 million at the end of the quarter, with most choosing the higher-priced plan. As more of our base moves to tiered plans and as data use increases, we expect our compelling ARPU growth story to continue.

Our wireless data results are on Slide 9. If our mobility chief Ralph de la Vega was on the call today, he would say something like, we had a blockbuster smartphone sales. Well, I'm not Ralph, but I've got to tell you, I share his enthusiasm. Our mobile broadband sales were nothing short of incredible.

Our wireless team sold 9.4 million smartphones or more than 100,000 devices a day for every single day of the quarter. That's nearly twice as many as we had in the third quarter and 50% higher than our previous record. Smartphone subscribers now make up about 57% of our postpaid subscriber base. That accounted for 82% of postpaid sales during the quarter. Much of this growth was driven by the launch of the iPhone 4S and record iPhone sales. But we also had record Android device sales, doubling sales from the year-earlier quarter.

Branded computing sales also had a best-ever performance. We added 571,000, thanks to strong tablet and tethering plan sales. We now have more than 5 million branded computing devices on the network.

Strong mobile broadband sales helped drive data growth. Data revenues were $22 billion in 2011, growing at 21% for the year. ARPU for smartphones continues to be strong, nearly twice that of our other devices. And about 87% of smartphone subscribers are on family or business plans. These customers are an excellent investment because they have lower churn.

I can't say enough about how well our mobility crew did in the fourth quarter. We not only held our own in a very competitive quarter but we set a new industry sales standard as well. But you don't have these results without having a terrific network. We are committed to creating not only the world's most advanced network but also the network most open to innovation. And we made tremendous progress towards this goal. Highlights are on Slide 10.

First, we had a great LTE launch last year, making AT&T the only U.S. carrier to provide 4G speeds through both LTE and HSPA+ technologies. This means we deliver the best possible blended speed which enables a better mobile experience for our customers. This pays off big for iPhone 4S customers with download speeds up to 3x faster than on any other carrier's network. You can also see the impacts of our CapEx investments in network upgrades and in expanded mobile broadband coverage. These investments are having a positive impact on our wireless quality metrics. As Randall mentioned, our average national 3G call retention has exceeded 99% since mid-September.

In 2012, we expect to double our LTE coverage with continued improvements in capacity and enhanced backhaul. We're very proud of what we have accomplished and full credit goes to our hardworking network team for an incredible effort.

Now let's look at wireless margins, details are on Slide 11. As you know, the investments we made to drive record smartphone sales and record upgrades have impacted wireless margins, but you also know long-term value of these subscribers: lower churn, higher ARPUs and strong data growth. Our strategy has been to grow this space, which we continue to do, while keeping existing smartphone subscribers in our network, which we did at record-breaking levels in the fourth quarter. Handset upgrades were about 12%.

Looking ahead, we expect service margins to improve in 2012. In fact, I expect we'll get service EBITDA margins back to 40%. Driving this will be continued strong but stabilizing smartphone sales during the year, helped in part by the full impact of the upgrade policy that was introduced last year. Additional revenues are expected from the new data pricing plans that we announced last week and greater efficiencies both in operations and billing. This really speaks to our long-term goal of building a strong smartphone base while working to improve margins.

Now let's take a look at the wireline business, starting with consumer, on Slide 12. U-verse continues to drive consumer growth: 6 straight quarters of year-over-year revenue increases. U-verse was a $6.7 billion revenue stream in 2011. That's almost triple the revenue from just 2 years earlier. And in the fourth quarter, revenues grew about 44% year-over-year. And as we scale, U-verse margins continue to improve, contributing to profitability.

During the quarter, we added 208,000 U-verse subscribers to reach 3.8 million customers in service. Meanwhile, our U-verse broadband net adds accelerated 3x our TV additions, which includes new U-verse small business subscribers. Faster broadband speeds plus mobility is a combination small business customers are looking for and AT&T's strength in both areas is a competitive advantage.

We're also seeing broadband and U-verse Voice over IP attach rates remain solid. With our U-verse build largely complete, we now passed more than 30 million living units, but penetration continues to expand. We now have 25% penetration in areas marketed to for 36 months or more and we believe there is a lot of room for growth. Our video service is recognized as the best in the business and we are growing faster than any other pay TV provider. In 2012, we expect continued U-verse subscriber growth, helping keep consumer revenue stable.

Now let's look at wireline business, which you can see on Slide 13. We have been watching revenue trends slowly get better in business even without the benefit of an improving economy. For the second quarter in a row, we had sequential revenue growth, thanks to growth in our strategic business services. That's things such as Ethernet, VPNs and application services, which were up 18.4% for the year, and it's now nearly a $6 billion business.

We are seeing positive trends in almost every part of the business. Our global enterprise business had its second straight quarter of year-over-year data growth. Wholesale had its third straight quarter of sequential revenue growth and revenue trends in small business continue to improve with another quarter of broadband growth. We now have 80% of our target central offices ready for IP DSLAM broadband sales and we'll soon begin selling into those central offices. This success helped wireline business margins improve year-over-year for the fourth consecutive quarter.

We expect these positive wireline business trends to continue in 2012 and that the wireline business will return to revenue growth this year, thanks to growth in network sourcing, mobility applications and virtualized services. And as we said, we expect this growth with little lift from the macroeconomy.

Now let's look at margins and cash flow. Consolidated comparisons are on Slide 14. Record-breaking smartphone sales and postpaid net adds considerably higher than initial estimates, had an impact on our consolidated margins. For the year, our adjusted consolidated operating margin was 17.8%. That compares to 18.5% in 2010. Our wireline operating margins were relatively stable from 2010. We were able to offset declines in legacy services in a sluggish economy, thanks to improving revenue trends, scaling IP data and solid execution with our One AT&T initiatives. Across the business, total force was down more than 10,000 in 2011.

In 2012, we expect to expand consolidated operating margins, driven primarily by wireless expansion with stable wireline margins.

Our cash flow story continues to be outstanding. Our cash summary is on Slide 15.

Cash from operations totaled $34.6 billion. Capital expenditures were $20.3 billion. Free cash flow before dividends was $14.4 billion, a very strong performance especially when you consider these things: We increased capital spending during the year; we made a $1 billion contribution to the pension fund in the fourth quarter; and a $3 billion payment as part of the T-Mobile transaction in the fourth quarter. Dividends totaled $10.2 billion for the year.

In terms of uses of cash, total debt is down almost $6.5 billion from the third quarter of 2011 levels with a debt-to-capital ratio of 38% and a net debt to adjusted EBITDA ratio of 1.5. And as Randall mentioned, we also plan to begin aggressively buying back stock from our previously authorized share buyback.

Looking ahead in 2012, we expect capital expenditures to be about $20 billion with continued investment in our growth drivers. And we expect free cash flow in the $15 billion to $16 billion range for the year. Our balance sheet is sound, our debt metric's solid. Our strong cash flow gives us the flexibility to invest or to retire debt while returning substantial value to shareholders.

Let me close with a quick recap of 2011 on Slide 16. We executed very well this year, with good momentum across our business. We grew revenues and had incredible cash flows. We set industry records for mobile broadband. Strength in strategic business services has business wireline poised for growth, and U-verse drove growth in consumer wireline. We also continue to invest in the future, almost $100 billion over the last 5 years. And we've done all of that while continuing to return value to our shareholders.

Let me also do a recap of 2012 guidance that we have provided throughout this call, that's on Slide 17. Looking at 2012, we have a solid strategic plan in place that will help us grow revenues, expand margins, increase earnings while continuing to have a very strong cash flows. In wireless, we expect to expand margins while growing postpaid ARPU by 2% for the year. We expect to return wireline business to revenue growth and keep wireline consumer revenues stable while also keeping wireline margins stable. We are targeting capital expenditures at the same level as 2011, approximately $20 billion. We expect free cash flow in the $15 billion to $16 billion range, and we will begin share buybacks.

This is a growth-focused outlook and also reflects our ability to execute on the cost side. We expect little help from the economy but are certainly prepared to take advantage of any opportunities that exist. This is a time of unprecedented growth for an incredibly dynamic industry. We have a great position and a solid track record of creating value for our owners and we expect to improve on that record in 2012.

Brooks, that concludes our prepared remarks. We are ready for Q&A.

Brooks McCorcle

Okay, great. Thank you, John. Okay, John, I think we're ready to open up for questions.

Question-and-Answer Session

Operator

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

Simon Flannery - Morgan Stanley, Research Division

Randall, I think one of the things you were hoping to get from T-Mobile was a better prepaid platform. Prepaid's about 2/3, 70% of the new subscribers coming on. Can you talk about how prepaid will fit into your strategy, given what Verizon and some others have done here recently for 2012? And perhaps, you could expound a little bit more on your comments about looking at underperforming assets. Might we see spinoffs of rural lines and sales of directories, is that the sort of thing we should be thinking about?

Randall L. Stephenson

On the prepaid platform, we've been rather transparent about the prepaid area in terms of when you're spectrum-constrained, you get really focused on the markets you want to pursue. And we have obviously been very, very focused on the high end of the market. And the beauty of T-Mobile was it not only came with spectrum, which would allow for some efficiencies, but then a prepaid platform that allowed you to move down market. As we're getting more and more of a better performance out of our network and as we move to LTE and begin to free up some of the 3G spectrum, this is probably an area that we'll look to for growth, Simon. In fact, we have a lot of work going on in this right now. I wouldn't expect or I wouldn't have you expect to see that in the next 6 months, but when you look at the next 12 to 24 months, prepaid will obviously become a focus for us especially when you think in terms of mobile data because, mobile data, that's probably an underserved area where that segment of the market does not have a robust data offering in a prepaid environment. So that will be a focus as we begin to mine out some capacity as we move to LTE. In terms of the underperforming assets, you hit a couple of areas. Obviously, we just took a rather large charge in our directory operations to reflect a lot of the current comparable pricing in the market for those types of assets. That's one area that we're going to obviously take a very hard look at. And while I don't want to give any indication of M&A activity, it's one of these areas where we're going to have to decide: Do we keep it, or do we restructure it as we move forward? So the other being rural access lines, we have been apprehensive on moving, doing anything on rural access lines because the issue here is, do you have a broadband product for rural America? And we've all been trying to find a broadband solution that was economically viable to get out to rural America and we're not finding one to be quite candid. The best opportunity we have is LTE and we were obviously rather excited about the opportunity to use LTE to get it to rural America with the T-Mobile transaction. That having been set aside, now we're looking at rural America and asking, what's the broadband solution? We don't have one right now. So you'll see some activity and some structuring changes over the next couple of months that will provide some idea in terms of where we're headed. We're going to have to either completely restructure those businesses. The cost structure has to change, not only the wage and benefit cost structure but just the cost structure associated with the technology, legacy TDM infrastructure out there. And leaving them as they are, they'll continue to be underperforming assets so we're going to have to make some fundamental changes, and there's more to come on that. But as I said, the next 12 to 24 months will bring more clarity to that, but these are areas that we as a company have to address in short order.

Operator

Our next question is from John Hodulik with UBS.

John C. Hodulik - UBS Investment Bank, Research Division

Randall, maybe picking up on the spectrum issue, maybe a little bit more detail, if you could, on your spectrum needs. I mean, obviously, you have some runway with the new 4G network, but you said you'd be more aggressive in that area or then, say, in 2012. I mean, what kind of opportunities are out there? I mean, is it more private companies like Aloha or even potentially other larger companies out there that are operating businesses that have spectrum that you guys could look at? If you could just characterize the sort of environment for new spectrum that already exists. And then maybe talk a little bit about, from a frequency standpoint, I mean, obviously, for you guys, the lower the better, but where would you look at spectrum? Basically trying to get a sense for how badly and how soon you're going to need new spectrum.

Randall L. Stephenson

Yes, okay, John, what I'd tell you is the immediate time frame. In terms of through our LTE deployment through 2013, I feel really good about where we are. We've got sufficient spectrum to get us through LTE deployment. And then, as you to begin to transition off your 3G networks to LTE, it'll buy you some more time in using data [ph] solutions and Wi-Fi solutions. But when you kind of look out and span the horizon or scan the horizon, there are no secrets. Everybody knows where the spectrum resides and who is holding it. Our biggest issue isn't identifying it and pursuing it. Our biggest issue is understanding what we're allowed to do. And we're literally sitting here in a situation where we don't know how much spectrum we're allowed to hold, who we're allowed to do business with and so forth. That was the basis of my comments in the opening session. We've just gone through a process where we tried to get a transaction approved and the FCC came out with a report and said that we exceeded the spectrum caps in over 200 markets. You can imagine how surprised we were to read that until you've read deeper into the report and realized they had changed the spectrum screens. It might have been nice to have known they were going to change those spectrum screens ahead of time, but that is what it is. Then literally, a couple of weeks later, they approve our acquisition of the Qualcomm spectrum, and in reading the report, they evaluated it using the old spectrum caps. So we're literally sitting here in a situation where we don't know what spectrum caps are going to apply from one transaction to the next. So our first issue is not identifying which spectrum we go after but identifying what the rules are. How will these transactions be evaluated? Who are we allowed to do business with and who are we not allowed to do business with? In terms of the frequencies that we're interested in, it's no surprise. We tend to favor the lower band, the 700-megahertz spectrum. We have a very, very good position in that particular location so we obviously have a lot of interest in the spectrum that resides down there. We've done a number of transactions in that particular area since the auctions occurred in 2007, so that's obviously an important area for us. AWS is obviously a good area for us to operate. We've launched our LTE network in the Chicago area on the AWS spectrum, that frequency, and it's performing quite nicely. So those would obviously be the priorities, but again, that's, the who and the what is not the question. It's what can we do and what are we allowed to do, it's the real question for us right now.

Operator

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

Michael Rollins - Citigroup Inc, Research Division

First on the wireless side, you've talked about the improvements in network quality but also that the network is running hot. Can you talk about the opportunities that you have to continue to manage the high quality of service to the broad base of HSPA+ customers and what the implications are for CapEx? And then secondly, a little bit more on the business side. If you could just give maybe an expansion of comments in terms of what you're seeing on strategic revenue growth and what's been driving the strong growth there. And also maybe what you're seeing on the legacy service guide, maybe some slowing in the rate of revenue erosion there?

Randall L. Stephenson

Sure, Michael. On the network quality side, wireless network quality, with T-Mobile behind us, we're back to blocking and tackling, if you will, and that means reinitiating significant sales splits. So we had a sales split strategy that was on hold till we got to the T-Mobile transition. So we're back to doing sales splits. We continue to go very, very aggressively on distributing the antenna system solutions and so going inside of buildings and lighting up buildings from the inside, Wi-Fi solutions, all of these, we just continue. And there's no new science here per se. Obviously, additional spectrum, where we can pick it up, is another part of the equation so you'll continue to see us be aggressive there. We have, I think we had some transactions approved by the FCC last week, but before last week, we had 8 transactions sitting in front of the FCC waiting for approval so we can begin investing. So you'll just continue to see us do a lot of the typical blocking and tackling. And you'll also see us, in markets where we've launched LTE, be very aggressive in migrating customers to the LTE platform. And if you're buying today an Android smartphone by -- from AT&T, you're probably buying an LTE-equipped handset, so as we turn up LTE in any of these markets, you're just inherently on the LTE network. So that obviously facilitates getting us the capacity relief that we need, as well. So it's going to be a number of initiatives. In terms of the business services side, what's driving it, again, there's no big secrecy here. VPNs are a huge part of this. Our business customers are moving aggressively to VPN solutions and we continue to run mid-teen type growth rates on VPN. The other is Ethernet, and native Ethernet solutions, whether to businesses, or a really big business opportunity for us right now is deploying this to cellular companies. Wireless companies are buying Ethernet to the sales side aggressively, as we told you. We now have 80% of our mobile broadband traffic on native Ethernet. All mobile companies are trying to get there as fast as they can. We think we're way ahead of the game in this regard. The benefits from it are dramatic in terms of the throughput increases you see by getting that backhaul infrastructure in place on Ethernet. So we're seeing big opportunities there and then lots of opportunities in terms of new application services that are riding on top. Once you put the VPN in place, customers are buying more and more applications and services that ride on top of that whether it be videoconferencing, telepresence and so forth, so we're having a lot of success there. So you put it all together, we continue to get 17%-type growth from these strategic businesses and service. That's helping offset the migration that we're seeing from a lot of the legacy products, as you said. So traditional voice continues to be in decline, as you would guess. Traditional data services, and really, they are somewhat flat, but data is growing in spite of flat legacy data services. So all in, we're feeling really good about the business side of the house. What I would remind you is that these strategic services are growing at this 17% clip and what we're seeing is still a very sluggish economy. I mean, this is not a high-growth economy. These businesses tend to invest in telecom as they hire people. These businesses have not been hiring but our spend from these companies and these services are growing. What we're hopeful for, and we're seeing some signs, just very kind of faint signs, but we're seeing some signs that maybe there's some economic tailwinds here. If we get those, then we think there's some serious upside to our business side of the house and business revenue growth.

Operator

Our next question is from Mike McCormack with Nomura Securities.

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

Randall, I guess, just thinking back about the introduction of the iPhone. And obviously, a lot has happened since then, but clearly, there was an expectation for an improvement and the approving of an NPV positive story. But maybe just help us with what the headwinds have been there because, if you look back over the past couple of years on churn metrics, ARPU growth rates and margins we're just, it just doesn't seem like we're getting the benefits of either iPhone or smartphone penetration. Can you just walk us -- I think voice is obviously an issue there, but any other headwinds that you think that you can address as we go forward? And then John, just thinking about the EPS guide, have you included a thought process on iPhone refresh?

Randall L. Stephenson

I guess what I would suggest is, while we've had margin pressures as we've gone deeper and deeper into the smartphone category, they continue to be high-NPV product categories. And in fact, the ARPUs are significantly higher than traditional mobile-phone-type capabilities. And to think that we're getting to 57% penetration of our smartphone base -- or of our postpaid base, excuse me, with smartphones and keeping margins in that 40% range, to penetrate that deeply and keep margins at this 40% range, I actually think is better than I might have hoped for. I -- it was a while before we had expectations that 80% of our sales would be in smartphone categories. But to sell 80% of all of your sales being smartphones and keep margins in this 40% range for the year, I, actually I'm not too disappointed with that. And I think it's going to prove to be a terrific platform for us because here's what we're seeing, Mike, and that is, you get a customer on smartphone and then you get a customer with FamilyTalk plans or family plans on smartphones and the smartphone becomes the platform for the new services that we're now selling. Somebody buys a tablet and puts their tablet on a 3G or 4G network. That customer puts that device on the same network as their smartphone. So we think it's going to prove to be a very important platform as we move forward. That's why we're not shying away from continuing to pursue this market. We have done some things where we've tightened up the upgrade policy to try to begin to manage the cost of the upgrades in this particular base. But all things considered, I'm pleased with the smartphone category and we'll continue to do things to tighten up margins as we go forward. We also took some actions during the course of this year that had an effect on our ARPU, and we believe it's going to prove to be a temporary effect on our ARPU, and that is, with 2011 being the year when we first had competition for the iPhone, we made some strategic moves. We introduced unlimited mobile-to-mobile calling if you had an unlimited text plan. That proved to be a very sticky move from a pricing standpoint, but it's had a negative effect on ARPU over a couple of quarters. We're seeing that stabilize now. We don't expect to continue to see that dilution on ARPU as we move forward, but that did have an effect this year that we think is largely behind us, and as we move to 2012, it should not continue to suppress ARPUs. But all in, it continue to be a bull, a big-time bull in the smartphone category and iPhones in general.

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

And just a, I'm sorry, Randall, just as a quick follow-up on that. You identified part of the voice pressure there, but are you seeing, obviously, upgrades are running pretty high across the entire industry, but are you seeing the people coming to the store for the upgrade to the smartphone, making decisions on how many voice minutes they want? Because it seems like, and I mean, I got a couple of younger kids, but they just don't talk on the phone anymore. So are we seeing sort of the pricing down to these lower buckets?

Randall L. Stephenson

Without a doubt. And well, you're seeing it from the phenomenon you just described, and that is, young people, it's almost uncool to talk on a phone, right? I mean texting and messaging are keys. But, and so that has had its effect. But also, when we did go to mobile-to-mobile calling, this will tell you how efficient these markets are, but people began to immediately, particularly in small business, small businesses immediately rightsized their plans to reflect the mobile-to-mobile calling feature. And so we did see a step-down very quickly, but as I mentioned, we're beginning to see that mitigate.

John Joseph Stephens

Mike, with regard to your question with regard to the 2012 expectations, 2 points on smartphone sales with an iPhone refresh: We do have smartphone sales flat compared to '11 in our expectations and that is in a 25-million-unit level, which is a record for us. So we did assume that we would have that same level again, and that's after we've fully implemented during this year our new handset upgrade policy so that also takes into account some growth opportunities.

Operator

Our next question is from Phil Cusick with JPMorgan.

Philip Cusick - JP Morgan Chase & Co, Research Division

First is just a follow-up on what you just said, John. So that's a flat from the fourth quarter smartphone run rate, right?

John Joseph Stephens

I'm sorry. We're going to -- we -- the annual run rate for the smartphones in 2011 was $25 million and we have plans that assume we're going to stay at that level for the year in 2012. It just may be mixed differently by quarter. That, in my opinion, is a significant number particularly since we'll have the new upgrade policy fully implemented this year.

Philip Cusick - JP Morgan Chase & Co, Research Division

Got it. So you would expect the upgrades to moderate somewhat in '12?

John Joseph Stephens

Yes.

Philip Cusick - JP Morgan Chase & Co, Research Division

Okay. So a bigger question: Can you talk about the wireline business a little bit? It just sounds like you said it'll turn positive in 2012. Does that mean sort of positive for the year, or at some point, maybe during the back half, it switches to positive? And then talk about margins there. So flat year-over-year, is there any potential for additional cost cuts? Or is that really sort of mix shift still and there's not much to be done with that level?

John Joseph Stephens

So I directly expect revenue to grow for the entire year, for the overall. Whether it occurs fully in the first quarter or it occurs later, it will occur for the full year. We expect revenues to grow. Secondly, there are additional cost opportunities and savings opportunities. We've gone a tremendous distance in getting our One AT&T initiatives and other cost efficiencies in place, but there's always, as one of my peers would say, there's always more, and we're going to continue to work for that more. We do have a headwind of continued legacy product challenges, and so those cost savings may go to offset that. And finally, as we've mentioned here previously, we're not assuming a significant lift, a measurable lift at all from the economy. And as such, if we had that lift, there would be an opportunity to perform better than what we've expected.

Operator

Our next question is from Jonathan Chaplin with Crédit Suisse.

Jonathan Chaplin - Crédit Suisse AG, Research Division

A couple of quick questions for John. So firstly, on the share repurchase, is there any impact of share repurchase that's included in your EPS guidance, and if so, how much does that contribute? And I'm wondering if you can just talk a little bit about how you sort of manage between wanting to take as many shares out as quickly as possible early in the year versus maintaining that 1.5x debt-to-EBITDA ratio. Can you go significantly above that and maybe implement something like an accelerated share repurchase program early in the year and then trend back down to that over the course of the year? And then, sorry, one final question: On the impact of the upgrade policy change, can you just run through when you think that impact will start showing up? And how much you think the upgrade rate could come down in 2012 over 2011?

John Joseph Stephens

So Jonathan, let me to try to take them in short order. First of all, with regard to the assumptions we made in the plan with regard to share repurchase, I would suggest to you, my guidance, our guidance for the year wouldn't be any different based on moving that share repurchase assumptions around. It wouldn't have changed -- it did not change the guidance we're giving you, so if we had no share repurchase, we'd stay with that mid-single-digits EPS growth. That's the first question, I hope that's responsive. The second question, with regard to our debt ratios, I think you need to understand, and I know you do, Jonathan, but I think you need to step back and look at our balance sheet today, with over $3 billion in cash on our balance sheet. Look at the cash flows that we are expecting to generate, over -- close to $6 billion over our dividend requirements. That total of $9 billion gives you a good insight into how much shares we can repurchase or can give you one insight into how much shares we can repurchase without affecting debt metrics. And so we'll be prudent. We are sticking to our standards with regard to the 1.5x and in the debt-to-equity kind of guidelines we've given. But we have cash generation. A company like ours has significant flexibility in the timing of those kinds of activities. The upgrade policy, I would expect it to go in full force at the end of the second quarter. We've put it in place in the first quarter of a year ago and it takes about a 1.5 years to be fully implemented. You probably won't see the full effects of it until the second half of this year. That's our expectations. I will tell you that, in this first year, we are expecting to see some improvement, but we have not given, and I don't believe we are giving guidance on the specific impact on upgrades. Anything else?

Operator

And next, we'll go to Jason Armstrong with Goldman Sachs.

Jason Armstrong - Goldman Sachs Group Inc., Research Division

Randall, maybe just a quick follow-up on the regulatory environment. What, in your mind, is the path to more clarity out of D.C.? What would you need to see from them? Or are we just to assume that you effectively need a complete reset at the FCC to contemplate anything else of size that you'd take to them? And then maybe just a quick follow-up on the upgrade percentage. Obviously, such a big swing factor for wireless margins. The industry seems to go through waves of tightening and loosening upgrade policies. Your latest move, obviously very constructive and tightening, but maybe you can talk bigger picture and longer term, can we as an industry get into a sustained period of tightening that would really reflect sort of a greater degree of discipline?

Randall L. Stephenson

Okay. In terms of the regulatory environment, Jason, I would tell you there is one thing that could be done in very, very short order that would kind of lift the veil or cloud of uncertainty surrounding a lot of this, and that is, Congress passes legislation initiating the auctions and it's very prescriptive to the FCC in terms of what the FCC's role is in the auctions. And the House has a bill that is, has been drafted and it accomplishes exactly that. The FCC is obviously contesting that language. I think the chairman made a speech the week after the holidays, the chairman of the FCC, where he said he needed the rules to be fluid. My interpretation is these rules are so fluid you can drink out of them with a straw right now. So what we need from Congress is prescriptive legislation on how these auctions should be performed. And the language is presently in the current House bill. If that bill were to get passed, I think it starts to lift the veil of uncertainty surrounding the industry. In terms of upgrade policy, Jason, what you're articulating and discussing is the indication of an incredibly competitive environment in the mobility world. And I think what you're beginning to see is the smartphone market is maturing a bit, and as it matures, I think you'll begin to see different behavior among all the players. I probably can't go much further than that, but our -- as I've said at the very beginning, I feel like we have about as much visibility into the future as we have had in quite some time, so that intimates a certain degree of predictability that has not been there before. And we'll see. We've built our plans and our margin expectations around selling a comparable number of smartphones as we did in 2011, so 25 million. Will there be some new iconic device that nobody anticipated come out during the course of the year? Perhaps. But I do think 25 million sales is probably a reasonable expectation for us. And if we can get, if we do a 25 million sales level, then a 40% margin is probably an achievable level.

John Joseph Stephens

Jason, one thing, if I could add, Jason, one point I'd make is, as we go through this transition in our network and the ability to provide LTE, one aspect of this refresh process, as Randall mentioned, that doesn't get loss on is we really don't necessarily have to give much in the way of financial incentives to get our customers, as this was clearly shown in the fourth quarter, to get them to go to the latest technology. So we have an opportunity to shift dramatic levels of traffic to LTE. Also, as the industry all begins to fall into a similar situation with us with regard to wireline, wireless handset subsidies and cost and structure, we would hopefully expect that everyone would act rationally in the process.

Operator

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

David W. Barden - BofA Merrill Lynch, Research Division

I guess, just first, John, when you mentioned that you thought that wireless margins could be as high as 40% in 2012, were you meaning that you expect it to be able to maybe touch 40% at some point in time, or is that kind of more of a full year look? And then on the consumer revenues, for the last couple of quarters, it looks like they've been coming down sequentially. I know you've talked about some of the headwinds that you're facing with the legacy businesses and trying to restructure those, but is there a risk that consumer revenues might dip back down into negative territory and then get offset by some of the advances in business, as we look in the 2012 mix?

John Joseph Stephens

First of all, on the wireless margins, the expectations I mentioned, 40% were for the full year. We'll see how the different quarters go because of volumes and new handset issuances and so forth, but the comment was intended for the year. With regard to the consumer revenues, a couple of things I think I'd point out to you. We've got the U-verse build complete or essentially complete. And we'll continue to do a little bit more here and there, but we've passed 30 million homes so now we have a full 30-million-home capability to sell into so we have opportunities to continue that growth. I think we mentioned that there was 16% penetration in our eligible living units, and in those that are longer than 36 months, we're more like 25%. The other piece of that is we're having tremendous results with our high-speed U-verse-type broadband, not only in consumer but in small business. And so those opportunity to sell into more U-verse markets and that continued push on high-speed Internet and attach rates for VoIP give me optimism over continuing to have a good performance in consumer. With that being said, we are expecting even better performance in business. And they've proven it, they've shown it. The strategic services give us factual support for that thought process.

David W. Barden - BofA Merrill Lynch, Research Division

If I could just follow up real quick, Randall, just one quick one for you. If we could just get your kind of take on the Verizon agreement with the cable companies, their cross-marketing agreement now kind of anticipating potential Verizon selling of cable products in your territory. How do you look at that transaction? Are you, would you support it at the FCC? How do you think about it competitively? What does it make you want to do to respond? That'd be very helpful.

Randall L. Stephenson

Yes, as it relates to them selling cable products, it's interesting. It was obviously, their footprints don't overlap so much and so I don't know. I think it'll be interesting to see how the FCC deals with it. It appears to me to be a logical transaction. I obviously will be watching very closely because, again, it's, hopefully it's one more data point on what the spectrum screens really are, which if it does nothing, it should give us some clarity on what we're able to do as we move forward. So we won't be a participant in terms of comments or anything on this, just watching as a very interested bystander, hopefully getting some indication on what it means for us in terms of what we're able to do.

Brooks McCorcle

Okay, John, I think we have time for one more question.

Operator

And that will be from the line of Craig Moffett with Sanford Bernstein.

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

I wonder if you can just help me, Randall, with the growth outlook. If I'm doing the math right, it looks like service revenue growth in the wireless business, excluding the hardware sales, has now actually dropped to about 4%, and as you said, the smartphone penetration is now at about 57%. How do I think about kind of re-accelerating growth in that business? Where does it come from since the incremental data penetration rates and the growth rates are starting to subside a bit?

Randall L. Stephenson

Yes, so 57% smartphone penetration. As we said, sales, smartphones represented 80% of our sales. So every time we peg what the penetration rate will get to, it seems like the percentage of sales moves up another notch. And so we think we still have quite a ways to run in terms of smartphone penetration and you continue, we'll continue to see ARPU lift as we penetrate smartphones more and more into the base. Also, I believe that what you're seeing right now, 1.4% postpaid ARPU growth, I believe you'll see that accelerate next year as we work through some of our unlimited mobile-to-mobile calling price changes. So we think we'll see some ARPU lift in terms of the growth rate, going into next year, so that will be very important. And then again, as I mentioned, I'm absolutely convinced the smartphone is a platform. And the customer that you hold with the smartphone is the customer that you will sell the tablet, is the customer that you will sell connected devices, is the customer you will sell home monitoring capabilities. We -- I just really believe that it's becoming more and more a factor in terms of, or a platform in terms of further penetration in mobile data and that's why we're going so aggressively on LTE. And then we haven't really begun to broach business mobility and business mobility in terms of applications. I think we're very early in the cycle in terms of businesses mobilizing all aspects of what they do, whether it be sales force automation or imaging, and there's just so many applications that businesses are just starting to get their hands around that will become a significant driver of growth. So I'm feeling pretty good that we have a long way to run in terms of growth in the mobile broadband infrastructure. You're seeing us invest heavily. We'll continue to invest, again, getting to LTE 80% coverage by 2013 and we just think it's going to be a terrific opportunity.

So with that, I, we're going to close. And I want to thank everybody for taking part. As I said, 2012, we've probably got the best visibility we've had in quite some time. Our growth engines are on track. It is being led, as you heard by our comments and your questions on this call, by mobile broadband. The key for us is spectrum. We need the FCC and Congress to get us, to open up and get us to a point of open auctions, and that needs to be done as soon as possible.

We're committed to making sure that AT&T is structured for growth. We're going to look at low-growth and nonstrategic assets and make some decisions over the next few months. And given this environment, we'll begin significant share repurchases and we'll do that immediately. So we're looking forward to a good 2012.

Thank you, again, for joining us, and we'll talk you later. Thank you.