AT&T INC.
Form 10-Q
August 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2008

or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number 1-8610

AT&T INC.

Incorporated under the laws of the State of Delaware
I.R.S. Employer Identification Number 43-1301883

208 S. Akard St., Dallas, Texas 75202
Telephone Number: (210) 821-4105

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	[X]		Accelerated filer	[ ]
Non-accelerated filer	[ ]	(Do not check if a smaller reporting company)	Smaller reporting company	[ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

At July 31, 2008, there were 5,893 million common shares outstanding.

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

AT&T INC.
CONSOLIDATED STATEMENTS OF INCOME
Dollars in millions except per share amounts
(Unaudited)

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Operating Revenues				
Wireless service	$ 10,894	$ 9,513	$ 21,499	$ 18,583
Voice	9,519	10,378	19,212	20,833
Data	6,054	5,746	12,026	11,401
Directory	1,383	1,155	2,781	2,177
Other	3,016	2,686	6,092	5,453
Total operating revenues	30,866	29,478	61,610	58,447
Operating Expenses				
Cost of services and sales (exclusive of depreciation and amortization shown separately below)	11,900	11,658	23,902	23,080
Selling, general and administrative	7,441	7,460	15,300	14,727
Depreciation and amortization	4,958	5,416	9,861	11,032
Total operating expenses	24,299	24,534	49,063	48,839
Operating Income	6,567	4,944	12,547	9,608
Other Income (Expense)				
Interest expense	(854)	(879)	(1,719)	(1,752)
Equity in net income of affiliates	212	210	455	383
Other income (expense) – net	(43)	127	(10)	631
Total other income (expense)	(685)	(542)	(1,274)	(738)
Income Before Income Taxes	5,882	4,402	11,273	8,870
Income taxes	2,110	1,498	4,040	3,118
Net Income	$ 3,772	$ 2,904	$ 7,233	$ 5,752
Basic Earnings Per Share	$ 0.64	$ 0.47	$ 1.21	$ 0.93
Diluted Earnings Per Share	$ 0.63	$ 0.47	$ 1.21	$ 0.92
Weighted Average Number of Common Shares Outstanding – Basic (in millions)	5,926	6,145	5,962	6,184
Dividends Declared Per Common Share	$ 0.400	$ 0.355	$ 0.800	$ 0.710

See Notes to Consolidated Financial Statements.

AT&T INC.
CONSOLIDATED BALANCE SHEETS
Dollars in millions except per share amounts

	June 30, 2008 (Unaudited)	December 31, 2007
Assets		
Current Assets		
Cash and cash equivalents	$ 1,631	$ 1,970
Accounts receivable – net of allowances for uncollectibles of $1,303 and $1,364	15,971	16,185
Prepaid expenses	1,671	1,524
Deferred income taxes	1,407	2,044
Other current assets	2,545	2,963
Total current assets	23,225	24,686
Property, plant and equipment	212,549	210,518
Less: accumulated depreciation and amortization	115,181	114,628
Property, Plant and Equipment – Net	97,368	95,890
Goodwill	71,528	70,713
Licenses	46,771	37,985
Customer Lists and Relationships - Net	12,568	14,505
Other Intangible Assets - Net	5,844	5,912
Investments in Equity Affiliates	2,838	2,270
Postemployment Benefit	17,898	17,291
Other Assets	6,468	6,392
Total Assets	$ 284,508	$ 275,644
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	$ 16,472	$ 6,860
Accounts payable and accrued liabilities	18,927	21,399
Advanced billing and customer deposits	3,573	3,571
Accrued taxes	3,782	5,027
Dividends payable	2,357	2,417
Total current liabilities	45,111	39,274
Long-Term Debt	63,675	57,255
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	25,136	24,939
Postemployment benefit obligation	24,832	24,011
Other noncurrent liabilities	13,817	14,798
Total deferred credits and other noncurrent liabilities	63,785	63,748
Stockholders' Equity		
Common shares issued ($1 par value)	6,495	6,495
Capital in excess of par value	91,647	91,638
Retained earnings	35,719	33,297
Treasury shares (at cost)	(21,420)	(15,683)
Accumulated other comprehensive income (loss)	(504)	(380)
Total stockholders' equity	111,937	115,367

Total Liabilities and Stockholders’ Equity	$ 284,508	$ 275,644

See Notes to Consolidated Financial Statements.

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AT&T INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Dollars in millions, increase (decrease) in cash and cash equivalents
(Unaudited)

	Six months ended June 30, 2008	2007
Operating Activities		
Net income	$ 7,233	$ 5,752
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,861	11,032
Undistributed earnings from investments in equity affiliates	(415)	(344)
Provision for uncollectible accounts	860	738
Deferred income tax expense (benefit)	1,384	(546)
Net gain on sales of investments	(27)	(64)
Gain on license exchange	-	(409)
Changes in operating assets and liabilities:		
Accounts receivable	(776)	87
Other current assets	274	(665)
Accounts payable, accrued and other liabilities	(5,117)	(287)
Stock-based compensation tax benefit	(14)	(107)
Other - net	242	(108)
Total adjustments	6,272	9,327
Net Cash Provided by Operating Activities	13,505	15,079
Investing Activities		
Construction and capital expenditures		
Capital expenditures	(9,320)	(7,460)
Interest during construction	(257)	(78)
Acquisitions, net of cash acquired	(10,087)	(221)
Dispositions	623	520
Proceeds from sale of securities, net of investments	(73)	509
Other	41	17
Net Cash Used in Investing Activities	(19,073)	(6,713)
Financing Activities		
Net change in short-term borrowings with original maturities of three months or less	6,590	(1,993)
Issuance of long-term debt	10,924	5,924
Repayment of long-term debt	(1,605)	(2,065)
Purchase of treasury shares	(6,077)	(6,904)
Issuance of treasury shares	310	1,252
Dividends paid	(4,802)	(4,414)
Stock-based compensation tax benefit	14	107
Other	(125)	(121)
Net Cash Provided by (Used in) Financing Activities	5,229	(8,214)
Net increase (decrease) in cash and cash equivalents	(339)	152
Cash and cash equivalents beginning of year	1,970	2,418

Cash and Cash Equivalents End of Period	$ 1,631	$ 2,570
Cash paid during the six months ended June 30 for:		
Interest	$ 1,863	$ 1,765
Income taxes, net of refunds	$ 4,730	$ 1,484

See Notes to Consolidated Financial Statements.

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AT&T INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Dollars and shares in millions, except per share amounts
(Unaudited)

	Six months ended June 30, 2008		
	Shares		Amount
Common Stock			
Balance at beginning of year	6,495	$	6,495
Balance at end of period	6,495	$	6,495
Capital in Excess of Par Value			
Balance at beginning of year		$	91,638
Issuance of shares			88
Stock based compensation			(79)
Balance at end of period		$	91,647
Retained Earnings			
Balance at beginning of year		$	33,297
Net income ($1.21 per diluted share)			7,233
Dividends to stockholders ($0.80 per share)			(4,742)
Other			(69)
Balance at end of period		$	35,719
Treasury Shares			
Balance at beginning of year	(451)	$	(15,683)
Purchase of shares	(164)		(6,077)
Issuance of shares	13		340
Balance at end of period	(602)	$	(21,420)
Accumulated Other Comprehensive Income (Loss), net of tax			
Balance at beginning of year		$	(380)
Other comprehensive income (loss) (see Note 2)			(124)
Balance at end of period		$	(504)

See Notes to Consolidated Financial Statements.

AT&T INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
Dollars in millions except per share amounts

NOTE 1. PREPARATION OF INTERIM FINANCIAL STATEMENTS

Basis of Presentation Throughout this document, AT&T Inc. is referred to as “AT&T,” “we” or the “Company.” The consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission that permit reduced disclosure for interim periods. We believe that these consolidated financial statements include all adjustments (consisting only of normal recurring accruals) necessary to present fairly the results for the interim periods shown. The results for the interim periods are not necessarily indicative of results for the full year. You should read this document in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The consolidated financial statements include the accounts of the Company and our majority-owned subsidiaries and affiliates. Our subsidiaries and affiliates operate in the communications services industry both domestically and internationally, providing wireless and wireline communications services and equipment, managed networking, wholesale services and directory advertising and publishing services.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Earnings from certain foreign equity investments accounted for using the equity method are included for periods ended within up to one month of our year end.

Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (FAS 157) requires disclosures for financial assets and liabilities that are remeasured at fair value at least annually. FAS157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. Substantially all of our available-for-sale securities are valued using quoted market prices (referred to as Level 1). Adjustments to fair value are recorded in other comprehensive income until the investment is sold (see Note 2). The fair market value of these securities was $2,570 at June 30, 2008.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimates of probable losses and expenses. Actual results could differ from those estimates. We have reclassified certain amounts in prior-period financial statements to conform to the current period’s presentation.

Valuation and Other Adjustments In accordance with Statement of Financial Accounting Standards No. 112, “Employers’ Accounting for Postemployment Benefits,” (FAS 112) we establish obligations for expected termination benefits provided under existing plans to former or inactive employees after employment but before retirement. These benefits include severance payments, workers’ compensation, disability, medical continuation coverage and other benefits. At June 30, 2008, we had severance accruals under FAS 112 of $369, of which $42 were established as merger-related severance accruals. At December 31, 2007, we had severance accruals of $127.

Included in the current liabilities reported on our consolidated balance sheet are accruals established under Emerging Issues Task Force (EITF) Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination" (EITF 95-3). The liabilities include accruals for severance, lease terminations and equipment removal costs associated with our acquisitions of AT&T Corp., BellSouth Corporation (BellSouth) and Dobson Communications Corporation. Following is a summary of the accruals recorded under EITF 95-3 at December 31, 2007, cash payments made during 2008 and the adjustments thereto.

	12/31/07 Balance	Cash Payments	Adjustments	6/30/08 Balance
Severance accruals paid from:				
Company funds	$ 540	$ (177)	$ 6	$ 369
Pension and postemployment benefit plans	129	(21)	-	108
Lease terminations	425	(56)	91	460
Equipment removal and other related costs	161	(18)	17	160
Total	$ 1,255	$ (272)	$ 114	$ 1,097

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

New Accounting Standards
Split Dollar Life Insurance In 2007, the EITF ratified the consensus on EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (EITF 06-4) and EITF 06-10 "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" (EITF 06-10). EITF 06-4 and EITF 06-10 cover split-dollar life insurance arrangements (where the company owns and controls the policy) and provides that an employer should recognize a liability for future benefits in accordance with Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (FAS 106). These are effective for fiscal years beginning after December 15, 2007. We adopted EITF 06-4 and EITF 06-10 on January 1, 2008, recording additional postretirement liabilities of $101 and a decrease to retained earnings of $63.

NOTE 2. COMPREHENSIVE INCOME

The components of our comprehensive income for the three and six months ended June 30, 2008 and 2007 include net income, adjustments to stockholders' equity for the foreign currency translation adjustment, net unrealized gain (loss) on available-for-sale securities, net unrealized gain (loss) on cash flow hedges and defined benefit postretirement plans. The foreign currency translation adjustment was due to exchange rate fluctuations in our foreign affiliates' local currencies and the reclassification adjustment on cash flow hedges was due to the amortization of losses from our interest rate forward contracts.

Following is our comprehensive income:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Net income	$ 3,772	$ 2,904	$ 7,233	$ 5,752
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	39	44	105	18
Net unrealized gains (losses) on securities:				
Unrealized gains (losses)	26	68	(64)	149
Less reclassification adjustment realized in net income	34	(40)	(16)	(40)
Net unrealized gains (losses) on cash flow hedges:				
Unrealized gains (losses)	(21)	(13)	(99)	(36)
Reclassification adjustment for losses on cash flow hedges included in net income	5	4	9	8
Defined benefit postretirement plans:				
Amortization of net actuarial (gain) loss and prior service benefit included in net income	(31)	56	(59)	104

Other		-		1		-		(1)
Other comprehensive income (loss)		52		120		(124)		202
Total Comprehensive Income	$	3,824	$	3,024	$	7,109	$	5,954

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AT&T INC.
JUNE 30, 2008

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

NOTE 3. EARNINGS PER SHARE

Reconciliations of the numerators and denominators of basic and diluted earnings per share for net income for the three and six months ended June 30, 2008 and 2007 are shown in the table below:

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Numerators				
Numerator for basic earnings per share:				
Net income	$ 3,772	$ 2,904	$ 7,233	$ 5,752
Dilutive potential common shares:				
Other stock-based compensation	2	2	4	4
Numerator for diluted earnings per share	$ 3,774	$ 2,906	$ 7,237	$ 5,756
Denominators (000,000)				
Denominator for basic earnings per share:				
Weighted-average number of common shares outstanding	5,926	6,145	5,962	6,184
Dilutive potential common shares:				
Stock options	15	26	15	24
Other stock-based compensation	21	24	20	22
Denominator for diluted earnings per share	5,962	6,195	5,997	6,230
Basic earnings per share	$ 0.64	$ 0.47	$ 1.21	$ 0.93
Diluted earnings per share	$ 0.63	$ 0.47	$ 1.21	$ 0.92

At June 30, 2008, we had issued and outstanding options to purchase approximately 209 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 104 million shares in the second quarter and 110 million for the first six months exceeded the average market price of AT&T stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective period. At June 30, 2008, the exercise price of 105 million share options was below market price.

At June 30, 2007, we had issued and outstanding options to purchase 261 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 95 million shares in the second quarter and 113 million for the first six months exceeded the average market price of AT&T stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective period.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. We analyze our various operating segments based on segment income before income taxes. Interest expense and other income (expense) – net are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in the calculation of each segment's percentage of our consolidated results. We have four reportable segments: (1) wireless, (2) wireline, (3) advertising & publishing and (4) other.

As part of our internal business unit realignment in the second quarter 2008, expenses were moved between line items (cost of sales and selling, general and administrative) and between segments (primarily wireline and other).

The wireless segment provides wireless voice and advanced data communications services.

The wireline segment provides landline voice and data communications services, managed networking to business customers, AT&T U-verseSM TV service (U-verse) and satellite television services through our agency arrangements.

The advertising & publishing segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. Results for this segment are shown under the amortization method, which means that revenues and direct expenses are recognized ratably over the life of the directory title, typically 12 months. However, consolidated results for 2007 directory operations acquired in our BellSouth acquisition are treated differently in accordance with Statement of Financial Accounting Standards No. 141, “Business Combinations” (FAS 141).

Under FAS 141, BellSouth deferred revenue and expenses from directories published during the twelve-month period ending with the December 29, 2006 acquisition date were not recognized in 2007 consolidated results. Accordingly, our consolidated revenue and expenses in 2007 related to directory operations were lower. Because management assesses the performance of the segment including the revenue and expenses associated with those directories, for segment reporting purposes, our 2007 advertising & publishing segment results include revenue of $306 in the second quarter and $715 for the first six months of 2007 and expenses of $119 in the second quarter and $227 for the first six months of 2007. These amounts are eliminated in the consolidation and elimination column in the reconciliation below.

The other segment includes results from Sterling Commerce Inc., customer information services and all corporate and other operations. This segment includes our portion of the results from our international equity investments. Also included in the other segment are impacts of management decisions affecting the entire company for which management does not evaluate the individual operating segments.

In the following tables, we show how our segment results are reconciled to our consolidated results reported in accordance with GAAP. The Wireless, Wireline, Advertising & Publishing and Other columns represent the segment results of each such operating segment. The Consolidation and Elimination column adds in those line items that we manage on a consolidated basis only: interest expense and other income (expense) – net. This column also eliminates any intercompany transactions included in each segment's results as well as the advertising & publishing revenue and expenses in the second quarter and for the first six months of 2007 as noted above.

Segment assets for the six months ended June 30, 2008 are materially unchanged from the year ended December 31, 2007 with the exception of the wireless and other segment assets. Our wireless segment assets totaled $123,620, which increased $17,667, or 16.7%, primarily due to the acquisition of wireless spectrum. Our other segment assets totaled $206,436, which increased $23,361, or 12.8%, primarily due to an increase in value of our investments in our subsidiaries.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

For the three months ended June 30, 2008

	Wireless	Wireline	Advertising &		Consolidation	Consolidated