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PRESENTATION

Operator

Thank you for standing by. Welcome to AT&T's First Quarter 2023 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would like to turn the conference call over to our host, Amir Rozwadowski, Senior Vice President, Finance and Investor Relations. Please go ahead.

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

Thank you, and good morning, everyone. Welcome to our first quarter call. I'm Amir Rozwadowski, Head of Investor Relations for AT&T. Joining me on the call today are John Stankey, our CEO; and Pascal Desroches, our CFO.

Before we begin, I need to call your attention to our safe harbor statement. It says that some of our comments today may be forward-looking. As such, they're subject to risks and uncertainties described in AT&T's SEC filings. Results may differ materially. Additional information, including our earnings materials, are available on the Investor Relations website.

With that, I'll turn the call over to John Stankey. John?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Thanks, Amir, and good morning, everyone. I appreciate you joining us. Earlier today, we shared our first quarter results, which again illustrate how we're meeting our commitment to grow high-quality, durable 5G and fiber customer relationships. Thanks to a consistent discipline and return focused go-to-market approach. Our team is balancing customer growth with profitable long-term value creation as we connect people to greater possibility.

And I'm particularly proud of the quality of our subscriber additions. Despite high promotional activity seen in parts of our industry, we continue to achieve consistently low churn levels while increasing the take rate of our high-value 5G and fiber plans. We believe our results demonstrate

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that the customer-centric strategy we launched almost 3 years ago continues to deliver the right mix of quality subscriber and profit growth that will prove sustainable over the longer term.

So let me highlight some of our progress. Let's start with mobility. In January, I shared that we anticipated industry demand trends would continue to normalize to pre-pandemic levels. However, we still expect it to grow both postpaid phone subscribers and wireless profits, thanks to investments in our customer experience, distribution channels and network, and that's exactly what our team's delivered.

We had 424,000 postpaid phone net adds in the first quarter and continued to grow wireless service revenues, EBITDA and postpaid phone ARPU, all while maintaining historically low churn. Checking the box for each of these success metrics paints a clear picture of what sustainable, profitable wireless growth looks like.

We've now had more than 11 straight quarters of 400,000 postpaid phone net adds or better, and we've totaled 2.6 million postpaid phone net adds over the past 4 quarters. We're pursuing longer-term growth by remaining committed to fostering durable relationships that solve customer pain points and bring great value to our customers.

We're executing well on our disciplined go-to-market strategy that centers around putting the customer first and takes advantage of our improved distribution.

We also continue to hone our ability to deliver targeted solutions that provide real value to customers in our historically underpenetrated segments, like first responders, as well as small and medium businesses. This approach establishes a long-term growth trajectory that thoughtfully balances customer additions with profitable returns.

Now let's turn to our fiber business. Quarter after quarter, our teams proved that wherever we build fiber, we win. And the first quarter was no exception, with 272,000 AT&T fiber net adds. This marks 13 straight quarters with more than 200,000 net adds. These net adds were a significant achievement with a number of household moves, a key growth metric for fiber sales, decreasing nationwide. As we noted at the end of last year, our fiber subscribers now outnumbered nonfiber and DSL subscribers. We now have about 7.5 million AT&T fiber subscribers, with the fiber adoption and margin expansion driving Consumer Wireline revenue and EBITDA growth.

We believe that AT&T offers the best wired Internet service available anywhere, that this elevated AT&T fiber experience is providing a strong tailwind.

So overall, across both 5G and fiber, I'm very happy with the high-quality subscriber adds we achieved in the quarter, and these long-term customer relationships provide a great and profitable revenue stream now and into the future. Even in the midst of increased macroeconomic uncertainty, we're executing more sharply and efficiently after repositioning our operations around our connectivity strengths. We remain on track to achieve our $6 billion plus cost savings run rate target by the end of the year, if not sooner.

As we mentioned before, the benefits from these efforts are expected to increasingly fall to the bottom line. While we've largely delivered what we set out to accomplish 3 years ago, our journey has only raised our confidence that we can continue to evolve and improve. In fact, we believe we can further accelerate cost take-outs as we progress through the year. Part of this entails transforming our network as we ultimately replace our copper services footprint with best-in-class fiber connectivity, and where it makes sense for customers, replacement products built on our wireless network.

Think about a cost structure that's no longer anchored to legacy network technologies and software stacks. For example, in addition to all of fiber's enhanced resiliency and its superior transport characteristics, we're already seeing that fiber uses less energy, costs less to maintain and requires fewer service dispatches.

And as we reduce our copper services footprint and related legacy infrastructure, we expect to consistently improve our margins, grow EBITDA and, ultimately, improve our capital efficiency.

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Another contributing element relies on unlocking new capabilities that make it easier to collaborate and get work done by leaning into our digital transformation. We're seeing this already come to life through early trials in our collaboration with NVIDIA, where we're testing the use of artificial intelligence to improve fleet dispatches so our field technicians can better serve customers. Separately, we're using AI to match customers with the right customer care support path, resulting in more effective issue resolution. We think this is only the tip of the spear of what's possible.

Now let's turn to our final priority, which centers on how we're allocating capital. We continue to invest in our 5G and fiber networks at record levels in order to deliver long-term sustainable earnings growth. Our goal is to build a network that not only meets today's demands but will serve the needs of our customers for decades to come. This is at the core of what we do and who we are as a company. It's also why we continue to be 1 of America's largest capital investors.

We're investing in our connectivity infrastructure, and using our team's proven expertise to not only maintain our network advantages but to advance it, and we're doing this while moving forward on our commitment to provide more Americans with access to reliable, high-speed broadband. We plan to actively pursue bead funding to support the transition of our wireline footprint and expect to be a significant participant in public, private partnerships.

And while we're clearly committed to investing in our networks, we also remain focused on the strengthening of our balance sheet and reducing our net debt. We expect to increase cash generation over time, which will allow us to continue delivering an attractive dividend with improving credit quality. And by executing on the simplified capital allocation framework, we expect to improve our financial flexibility in the long run. This will provide us with the opportunity to take additional actions, such as investing to accelerate our business growth or generating incremental values and returns for our shareholders.

Now before I wrap up, I'd like to quickly touch on some developments we're seeing in the macroeconomic environment. We started the year with the expectation that we'd be operating against a less-predictable macro backdrop. This belief has proven true thus far. And what we're seeing is in line with the expectations we built into our guidance in January, including a moderation of growth for wireless services.

We expected to transition back to more historical cost of debt. That is certainly underway, with the added dose of tighter credit availability to some segments of the economy. I'm clearly not breaking any ground with these observations, but this is why we have been focused on reducing our leverage and optimizing our use of capital over the last few years.

As the economy adjusts to a likely period of tighter capital availability and higher interest rates, I take comfort in the state of our business for 2 reasons. The first is the heavy lifting we did to strengthen our balance sheet over the last several years. We've reduced our debt, taking advantage of the prior low interest rate environment on our remaining debt and managed our debt towers for the next several years. As a result, more than 95% of our debt is now fixed at an average rate of 4.1%.

The second is the repositioning of our business to focus on exclusively communication services, particularly 5G and fiber. As the last few years have demonstrated, the solutions we provide are more critical than ever before, and we only expect the demand for purpose-built, best-in-class Internet access to grow. The resiliency of the services we provide, coupled with our improved financial flexibility, provide us with the right tool set to navigate the economic environment.

We remain on track to deliver the 2023 financial and operating commitments we made to our shareholders at the start of the year. However, should the need arise, we feel comfortable using the tools we have at our disposal to align our actions with a more challenging economic backdrop, whether that's accelerating cost transformation actions, being more deliberate with our capital spend or increasing our liquidity.

To conclude my remarks, I'd simply reemphasize that I'm proud of how our team started the year. Last quarter, I said that our approach and strategy for 2023 was to do it again. In the first quarter of the year, our teams have done just that.

With that, I'll turn it over to Pascal. Pascal?

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Pascal Desroches - *AT&T Inc. - Senior EVP & CFO*

Thank you, John, and good morning, everyone. As you know, we typically provide a brief review of our subscriber trends at this point in our prepared remarks. But today, I'd like to zoom out and connect the dots on the progress we've made so far on our multiyear journey to reposition our core operations.

Our goal has been to take advantage of the expected increased demand for wireless and broadband connectivity by adding customers the right way, with a focus on long-term value. We recognize that in order to do that, we had to increase our investments in the business to enhance our customer value proposition and make more memorable and lasting connections with our customers. We understood that these investments would have a short-term impact on wireless ARPU and profits, but over time, would build durable customer relationships and deliver attractive returns.

Over the last few quarters, we've started to see the full picture and the results of these efforts. In mobility, our largest business unit, we're growing subscribers and taking share. We also continue to see very healthy ARPU. This translates to growth in wireless service revenues and EBITDA, while improving margins. We've grown both revenues and EBITDA year-over-year for 4 consecutive quarters, and this past quarter was the best first quarter for mobility EBITDA in the company's history.

In Consumer Wireline, we've invested to increase our fiber footprint to provide customers with best-in-class access technology. Over the course of the past 3 years, we added about 6 million fiber locations that we can now serve. By doing this, we successfully transformed the business that was in secular decline into a growth business, with fiber growth outpacing legacy wireline declines. The consistency of our results across 5G and fiber provides us with confidence that our go-to-market approach is both sustainable and delivers attractive returns.

These results are the outcome of the hard work our teams have done and show the value in what we've been working towards the last 3 years, and now it's about continuing to deliver quality growth with attractive returns. So again, we're clearly growing the right way and focused on the long term.

Now let's turn to our first quarter financial summary on Slide 6. Consolidated revenues were up 1.4% in the first quarter, largely driven by wireless service revenues and to a lesser extent, Mexico and Consumer Wireline. This was partially offset by an expected decline in Business Wireline as well as lower mobility equipment revenues. Adjusted EBITDA was up 3.9% for the quarter as growth in mobility, Mexico and Consumer Wireline were partially offset by an expected decline in Business Wireline.

Adjusted EPS was $0.60 compared to $0.63 in the year ago quarter. In the quarter, there were about $0.06 of aggregated EPS headwinds from higher pension, lower DIRECTV equity income and higher effective tax rate. This was partially offset by strong growth in mobility. Cash from operating activities came in at $6.7 billion versus $7.6 billion last year. This was largely due to the timing of working capital, which includes lower securitizations. As a reminder, the first quarter is typically the high watermark for device payments, and we expect payments to progressively get lower as we make our way through the balance of the year.

Capital investments were $6.4 billion as we continue to make historically high levels of investments in 5G and fiber. Free cash flow for the quarter was $1 billion. This was consistent with our expectations and accounts for several seasonal and anticipated working capital impacts. We remain confident in our full year outlook for free cash flow of $16 billion or better. This expectation is largely due to the timing of capital investments, device payments, incentive compensation, which all peaked in the first quarter.

Now let's look at our mobility operating results on Slide 7. Before we get started, we disclosed in early March that we modified our business unit reporting and no longer record prior service credits to our individual business units. Prior period business unit results have been recast for this change. There is no impact to consolidate the operating income, as price service credits continue to be recorded in other income.

Looking at our Mobility results. Revenues were up 2.5% and service revenues were up 5.2% driven by subscriber growth and higher ARPU. Mobility EBITDA was up $621 million or 8% for the quarter, driven by growth in subscribers, service revenue and the assets of 3G network shutdown costs versus the first quarter of 2022. Mobility postpaid phone ARPU was $55.05, up $1.05 or nearly 2% year-over-year. ARPU growth remains largely driven by higher ARPU on legacy plans from last year's pricing actions, a continued mix shift to higher-value rate plans and a continued improvement in consumer international rolling trends.

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Postpaid phone churn remains low at 0.81% for the quarter. We believe our team's ongoing success can be largely attributed to the consistent investment we've made to build a fast and reliable 5G network and the actions we've taken to ensure our customers feel valued and appreciated. In prepaid, we had 40,000 phone net additions. Our total prepaid churn was below 3%, primarily driven by loyalty from Cricket customers who stayed with us as a result of our value and reliability. Overall, I'm really pleased that the team achieved solid subscriber growth even against a moderation in industry demand.

I'd like to also quickly acknowledge the strong results posted by our team in Mexico. We're very pleased with the performance of our Mexico wireless operations, which boasted strong revenue and steady profit growth, thanks to improved operational execution and scale.

Now let's move to Consumer and Business Wireline results, which are on Slide 8. Let's start with Consumer wireline where our growth was led by our investment in fiber, which is consistently yielding strong returns. We added 272,000 fiber customers in the quarter. This speaks to the quality of the service we're providing and the continued demand for the best Internet technology available today. With our fiber subscribers now outnumbering our nonfiber subscribers, the increasing mix shift from legacy products to fiber continues to drive strong broadband results.

Broadband revenues grew by more than 7% year-over-year, including accelerated year-over-year fiber revenue growth of more than 30%. Fiber ARPU was $65.92, up more than $1 sequentially, with ARPU for new fiber customers at about $70. Customers are increasingly choosing to take advantage of the benefits offered by faster speed tiers, which is also supporting ARPU growth.

Consumer Wireline EBITDA grew 3.2% for the quarter due to growth in fiber revenues and transformation savings, partially offset by higher storm costs on the West Coast, which hurt growth by about 250 basis points in the quarter. Overall, we could not be more confident in the future of our Consumer Wireline business, with fiber well positioned to lead our growth in the decade ahead.

Turning to Business Wireline. EBITDA was down $230 million year-over-year, which was in line with our expectations. This was partially driven by about $50 million in year-over-year comparability factors, including favorable compensation adjustments in the first quarter of last year. Our rationalization process in Business Wireline also continues as we remain focused on the opportunities that 5G and fiber expansion create, particularly in the small and midsized business category.

Our Business Solutions wireless service revenues grew nearly 7% despite a moderation in industry growth as we continue to grow faster than our peers. One driver of this growth continues to be FirstNet, where wireless connections grew by about 300,000 sequentially, about 40% of which are postpaid phones. Ultimately, we're making progress on transforming our Business Wireline operations. And when we normalize out for onetime comparison items in the quarter, we still see the same underlying trends and continue to expect full year results aligned to what we guided in January.

Now to wrap up my comments. I'll restate that we embedded expectations for a comparatively slower macro backdrop in our full year outlook and, therefore, remain on track to deliver on our full year guidance. We will continue to monitor the economy closely. And if we find ourselves operating in a more challenging macro environment than we anticipated, there are levers to pull. Ultimately, we feel like we have found the right formula to deliver sustainable results with profitable 5G and fiber subscriber gains.

We've demonstrated this by growing consolidated EBITDA, improving ARPUs and growing broadband and wireless service revenues, with consistently low postpaid phone churn, and we are confident that this formula will continue to work.

Amir, that's our presentation. We're now ready for the Q&A.

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

Thank you, Pascal. Operator, we're ready to take the first question.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from the line of Phil Cusick with JPMorgan.

Philip A. Cusick - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

Let's start with free cash flow. Given the 2Q free cash flow guide down last year, what can you add to your comments already to get investors comfortable that we aren't walking into another one of those?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Phil, thank you for the question. Overall, our -- we came in exactly as we anticipated. Remember, in my commentary on at the year-end when we gave guidance, we said that Q1 was going to be the low watermark for free cash flow for several reasons. One, it's the highest quarter of device payments. Recall, Q4 holiday sales is the heaviest volume for devices we pay for those in Q1. You saw our capital spend is elevated relative to the annual guidance that we gave. And Q1 is the quarter we pay incentive comp. When you factor all those things in, along with our expectations that we will continue to grow EBITDA, we feel really good about delivering $16 billion or better.

Philip A. Cusick - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

Maybe if I can follow up there, and forgive me if this is a little amateurish. But just looking at the balance sheet as of June '22, net debt today is $3 billion higher than it was 9 months ago. Given all the things that are happening, I understand there are other uses of cash, but is there a point at which the cash generation over and above the dividend starts to actually pay down the net debt of the company?

Pascal Desroches - *AT&T Inc. - Senior EVP & CFO*

We expect net debt to decline this year and thereafter.

Operator

Our next question comes from the line of Simon Flannery with Morgan Stanley.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

I wonder if you could just give us a little bit more color on the fiber. How is the build program going? I think I saw about 600,000 passings in the new locations on the consumer side, but just update us on that 2 million to 2.5 million build program. And also what you're seeing in terms of cohort penetration and take rates. You did slightly lower move activity, but how the kind of the 12-month, 24-month penetration rates are going? And then any updates on timing or structure around GigaPower would be great?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Sure, Simon. Look, everything is going great. It's no concerns whatsoever about ability to execute the build, supply chain spine. Resourcing capabilities within the vendor community is all good. Teams are executing well. I don't think I have any different commentary of, yes, there's been a little bit of inflationary pressure in some places. By far and away, it's all manageable. It's nothing that blows the business case.

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In fact, when you offset the cost per living unit increases against what is actually turning out to be faster penetration and higher ARPU than what we had in the, I would call, the fundamental business case, and when we started this process, it well offsets anything we have to worry about in terms of [burst] cost. So I would tell you from a perspective of we feel very comfortable with what we've told you about our $30 million commitment and where we're going with that. That's not the thing that's taking my time or keeping me up at night.

Where we are in terms of our execution, I would probably take my hat off to a couple individuals in the company that have been working very hard in this area. And I would tell you, relative to what we spend and how we're going about doing it, I think we're doing a much better job of penetrating our base faster than we are, as I just mentioned. I think that gives us confidence. I've shared with all of you before that 1 of the 3 major impacts to improving payback in a fiber business case is if you can penetrate faster than what your expectations are and bring cash flows forward that has an outsized impact on the NBV of the case and the ultimate payback, and we're seeing that happen.

Now I would tell you, look, we're building in places that are fiber hungry. And so I think our effectiveness is indicative of the success of the market and the receptiveness of the market. I don't know if you get 3 years out on the build if it stays that way. We'll have to continue to watch that. But I think the tactics and the techniques that we've developed collectively as a team between how we promote the brand, what our operations folks do to raise awareness, how we capture those customers, the way we're marketing to them, the effectiveness at which we're marketing to them, I really like what we're seeing.

And I think as we continue in this path, we're on the learning curve, and we're going to get better because we're on that learning curve, and we're getting scale on what we're doing. And that's all goodness. On the GigaPower side, we're in good shape. We're very close to closing on the transaction. You should expect that imminently. We're trying to do it the right way and feel very comfortable. We're going to get it done the right way. I will also tell you we have our first -- even though the transaction hasn't closed, we have our first live customer up in one of our markets.

So we are in place with all the infrastructure that we need to be able to sell and support customers through our channels. And I want to stress, we are the first seller of product on that infrastructure, and it's not an insignificant accomplishment for us to be able to have everything through the processes of activating our distribution channels and out of region markets so that they can talk to customers and sell and support the product and service, and we can drive the kind of penetration that we want to drive in that infrastructure.

So we feel really good about the progress there. And I will just tell you anecdotally, as I work around the organization, I felt very strongly about our competency and our ability to go and start doing this. I like the energy I see in the teams that are involved in it who feel probably even more confident than I do about it. And they have a lot of motivation to do well there, and I think that's going to serve us well as we move forward.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

Great. And just one last thing. On fixed wireless, you're getting a lot of more C-band spectrum, you have 3.45 coming on. How are you thinking now about -- for the copper catch and then potentially out of region doing more in fixed wireless to address the desire for converged bundles?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Yes, nothing's changed in my commentary here, Simon. We're out in the market today. We have a consumer product that's there that we've recently brought into play. We are in the process of scaling it so that we make sure that we do it the right way. And we are going to use it where we think we can offer the customer a better set of services than what they currently have, especially when we have an opportunity to go and use it to hold as we're going to build fiber over the next couple of years and come in behind it.

Where we have that network capacity, to your point, we are adding spectrum in. We have places where we have capacity, and it's a smart play for us to do that to keep a customer in the family. Also uses an opportunity, in some cases, to cross sell and add wireless into the portfolio as we do that. And we will run that play in consumer where it makes sense to run that. And we're seeing good feedback from our customers that we've put out the product with in the consumer space. We are seeing substantial improvements in their service levels. That's a good thing, and we feel that, that's the right way to kind of target and use the product.

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On the other side of the equation, as I've said many times before, this product is incredibly well suited to parts of the business segment. It's not only well suited in the near term, but it can be a long-term viable product, given the characteristics of how businesses use data depending on the type of segment you're serving. And we've had really good success in business deploying the product. We will continue to deploy it. And feel really good about it in that regard that when we match the product to the right user profile, the right segment profile, it can be a very, very viable opportunity for a sustainable and effective product. And we're seeing that, in fact, play out in the market right now.

Operator

Our next question comes from the line of John Hodulik with UBS.

John Christopher Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst*

Great. Maybe a question similar to Phil's first question on free cash flow, but related to EBITDA. You guys did 3.9% growth this quarter against 3% guidance, but you've got some easy comps on the wireless side. So anything you can tell us about sort of the color you have or the sort of confidence you have in hitting that 3% number. You also called out some storm costs in California, any other sort of one-timers inside of these numbers that can give us more comments?

And then lastly, on the cost side, you guys have been aggressive taking out headcount. And John, you mentioned potentially accelerating the headcount or the cost-reduction initiative. So just any additional color there. Is there more headcount to go? How far through the $6 billion are you? And should we see that translate into better margins?

Pascal Desroches - *AT&T Inc. - Senior EVP & CFO*

John, here is the way I would characterize the quarter. It was a really solid nearly 4% growth. There are -- yes, there were 3G shutdown in the prior year, but there were also some items that went the other way. So when I pierce through all of that, all the onetime items, this is right in line with the expectations we set at the beginning of the year of 3% or better growth.

John T. Stankey - *AT&T Inc. - CEO, President & Director*

So John, West Coast, I think, is pretty well publicized in what went on out there relative to the rains, and we still have a large, I'll call it, legacy footprint that ultimately we're spending a lot of time and energy and working our way out of. And you see what happens still when you get a lot of wetness on copper, it just doesn't work well. And I think this is one of the things that gives us a high degree of confidence we have opportunities for additional cost takeout in this business.

As we reposition to 5G and fiber, that cost structure we still carry. And I'm really pleased we made some changes about a year ago in how we organize within the business and how we focus on our operating cost structure that is putting the right kind of exposure on how we execute around that cost migration. So this is partly an answer to your question of what was unusual and also what we expect to do moving forward beyond the $6 billion. We will now start to see some momentum build in that regard as we begin to shutter legacy costs in the business, and I think we're making the steps that need to be made to be able to do that on a geography basis, as opposed to we don't need to see the last customer disappear before costs start to come out of the business.

And so we have much better instrumentation. I think we're building the muscles around how to do this. It's not easy stuff. I will admit to that. I would -- I wish we didn't have to spend as much time and energy on it, but we are. And I think we're getting it into a place that I've watched this business for years, that the flywheel will start to turn and we'll get the benefits out of it. And I feel really good about that.

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And I think that's when I talk about moving beyond the $6 billion. One of it is it's the fundamental restructuring of the business and getting to the backside of that. You may have noticed as well to show you how serious we are about this and how aggressively we're working it. We made a large filing that's public in California about restructuring the regulatory construct in California. That proceeding will take place over the course of the next year. And it's one that we've been working really hard with policymakers out there to do it the right way, make sure that we step up to serving customers in a way that accomplishes public policy objectives, while at the same time, positions the business well for a sustainable, cost structure and incentive investment in the state moving forward. And I'm confident that we can move through that process.

The last thing I'll just comment on in the first quarter, you probably saw that the weather patterns broadly across the United States were pretty challenging. And so while they were most pronounced on the West Coast, we were chasing a lot of issues broadly with ice and a variety of power dynamics that we're moving on. And I would say just generally speaking, it was not a friendly quarter to operating costs just to deal with the things that we need to deal with to make sure the network keeps running. And I think we came through it in pretty good shape relative to our commitments. And I think that's one of the things that we believe will be in good shape from a cash production perspective as we move through the year.

Operator

And our next question comes from the line of Brett Feldman with Goldman Sachs.

Brett Joseph Feldman - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Two, the first one is actually a quick follow-up to John's question and the second one is on wireless. So the follow-up is, with regards to your headcount reductions, typically there are costs associated with your workforce, whether it's severance or other separation costs. I don't think you're adding that back to your adjusted financials. So I'm just curious if you could potentially size what the impact of those costs have been.

And then on wireless, as you noted, you're expecting this normalization of wireless sector trends, you've already seen some of that in the first quarter. I'm curious how that's impacting the way you go to market. In other words, have you resized your advertising and your marketing budgets? Have you, in any way, narrow the scope of who's eligible for some of your best offers? And you're also coming up on almost a 1-year anniversary of the last time you took some price, I'm curious how you're thinking about pricing power in this environment?

Pascal Desroches - *AT&T Inc. - Senior EVP & CFO*

Brett, on the first part of your question, the thing to keep in mind is as it relates to Q1, a lot of the headcount reduction we saw in Q1 was accrued for as of the end of the year that was in the prior year numbers. So really didn't impact Q1 materially. By and large, look, this is a program we've been on for the last several years. And March will -- we expect it to continue, and it's one that in the normal course will incur severance on those, but it's all pretty manageable within the context of this company.

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Brett, what I would tell you on the go-to-market side is there really hasn't been any change at all. In fact, I think the headline is we're doing what we've been doing. And we're going after customers that we think are profitable customers, and we're doing it in the same way. And some of that is just a matter of -- I think the variable piece of it is when you're doing subsidy on a customer-by-customer basis, there's, of course, adjustment in that. So as you see volumes come down, certain equipment costs and the like are going to resize themselves to those volumes.

But when you start thinking about how we're promoting in the market, I won't say that there's going to be any substantial changes in anything that you see on distribution channel costs or go-to-market costs that would be anything different than the variable cost of moving from volume of 700,000 net adds to 400,000 net adds that might flow through things like commissions and equipment costs, et cetera, that are pretty typical.

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Look, we continue to always look for places where we can manage the value equation. And we opened with some of the comments in the prepared remarks deliberately to demonstrate to you that, I think, we do a pretty effective job of that. If there's something I would ask you not to lose is we're coming off the most profitable quarter and most lucrative EBITDA generation in our wireless business in its history and it's got the goodness of low churn, higher ARPU and customer growth. And that equation is there, and we're managing it deliberately. And you don't just pull one lever to make that happen. There's all kinds of things that have to come together and the recipe, one of which is where you have opportunities to move customers up a continuum or you have opportunities where you maybe are priced differently to market, you use those levers. And we'll continue to do that as we move through the year. And I think our confidence in doing that is indicative of the guidance that we've given you as we move through it.

We dynamically watch credit in the market. That's -- it's algorithmic in many instances. We do things as we go through the year. We're looking at a variety of different things in a variety of different segments, and we adjust. That's not new to this moment in time. That's something we do kind of dynamically as we run the company. We've been making adjustments to different segments and different offers consistently. And I would say, look, as we move through the year, if circumstances change or we see particular segments being stressed in different ways, well, we'll do things to adjust the availability of certain offers in certain places, yes. And have we done that and is that just a normal course of business? Yes to that as well.

Operator

And our next question comes from the line of Michael Rollins with Citi.

Michael Ian Rollins - *Citigroup Inc., Research Division - MD & U.S. Telecoms Analyst*

Just curious if you could unpack a little bit more of the slowdown in wireless postpaid phone performance in terms of the industry impact versus what you're seeing in the share of gross adds. And within that context, if you could provide some color on the activity levels that you're seeing between the consumer and the business segments?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Sure, Mike. So first of all, I don't think there's anything that I see. We're the first to report, so I don't know numbers from elsewhere. Obviously, we use many of the same vehicles you use to sense what's going on in the market, to determine. I would tell you that my conclusion right now is we're seeing, what I will call, proportional dynamics going on in the market. I think status quo is the way I would characterize it. As things kind of roll out here, I wouldn't -- I'll be surprised if it's dramatically different than ratios that we've seen from previous quarters right now, which I feel pretty good about, frankly, given our discipline around how we've been going after the right kind of customers. I think the value proposition is still strong.

I would tell you that on the customer base side, we've seen probably places in both segments where consumer at the lower end of the market are probably making the kind of decisions that people make when money is a little bit tighter. They're maybe extending the use of their device a little bit longer. It's not an issue of them not wanting the service, they're just making a decision to stick with their current handset a little bit longer and maybe pushing that discretionary decision to move up. So we've seen a little bit of a drop-off relative to some of the traditional upgrade rates and the shopping rates associated with that.

And then I would tell you in business, it's probably a combination of things going on. One is, as we've told you, going through the COVID period, there was better-than-projected growth I think. And we have been saying all along that some of that was being driven by COVID itself. Businesses that needed solutions to deal with the change in their operations, and that could have been how they were dealing with things in a more remote fashion or it could have been what they were doing with their employees to equip them to work outside of the office. As people have been coming back into work and as the economy has been normalizing, some of those products and services have reached their point of use that they no longer need them. And there's a little bit of that going on where people are making their businesses more efficient and trimming.

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And the wireless business is, of course, correlated to headcount and as some businesses have done some things to trim their employee ranks, you see that flowing through on handsets and data cards and things like that. It's, again, nothing that's out of the pattern of what we expected in terms of overall growth in the industry. We still have very healthy business services growth. We feel very comfortable about our share. We've shared with you in the opening remarks that we're penetrating in segments like in the public safety area better than the market in total. And all considered, that's pretty consistent with what we expected this year.

Pascal Desroches - *AT&T Inc. - Senior EVP & CFO*

Mike, one other point just to underscore. When we look at some of the key measures like porting ratios, our level of churn, those would all suggest, as John said, we are doing just on relative to the overall population of growth that is out there in the industry. So we feel really good about our performance, and it's really in line and consistent with our expectations of a normalization of consumer demand that we expected to come in 2023.

Operator

And our next question comes from the line of David Barden with Bank of America.

David William Barden - *BofA Securities, Research Division - MD*

I guess 2, if I could. The first one, Pascal, thank you for sharing the supplemental free cash flow walk to the adjusted EBITDA number. I think that one of the things that stands out there is the negative $2.7 billion working capital. And if I wanted to look at this page and think about how it looked for the full year 2023 based on your prior comments, that working capital number would have to be positive, which is a huge change, and it's very hard for us on our side of the fence to really model and understand and see. So if you could be as granular as possible about explaining how that changes over the course of the year would be super helpful.

And then, John, if I could ask you a question. Something material that's changed over the course of this quarter is that DISH has kind of become a distressed security, both in the equity and in the bond markets. And I think that -- my question is, has that changed your calculus about the potential for a DTV-DISH combination? And/or is that a potential opportunity for new spectrum acquisition, if that were to come about, or is new spectrum not really a priority for your capital allocation? I'd love to hear your thoughts on how that evolution is impacting your thinking?

Pascal Desroches - *AT&T Inc. - Senior EVP & CFO*

Dave, here's what I would point you to. Within the first quarter, as I mentioned in my prepared remarks, there is -- we are at the high watermark of our device payments. And it's the only quarter that has our annual incentive compensation. Those 2 things, coupled with our elevated CapEx relative to our full year guide, hurt Q1 to the tune of $3 billion to $4 billion, and we expect that to turn during the course of the year just mechanically. It really isn't much harder than that. Like based upon our spend -- what we expect to spend in those categories, those should turn mechanically. So we feel really good about being able to deliver 16% or better.

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Dave, on your commentary on DISH, I don't want us stipulate necessarily to your characterization. I'm sure Charlie probably doesn't stipulate to them. But first of all, I've never really commented on my point of view of what the calculus is in the combination of DIRECTV and DISH, and I don't expect to do that today. It's just not something we typically speculate on. I think Charlie has been the one that largely had commentary on that. He's certainly entitled to do that. So you might be a better person to ask given the circumstances, he's probably far more intimate to his business than I am.

Look, I think we step back all the time and ask ourselves what's the structure of the industry moving forward and what's going to occur. And I think I would just say the best way to maybe sometimes predict the future is look at the past, which is when there's been valuable spectrum available

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through any form or fashion, whether it is the decision to do a combination of a business, like what we did with LEAP, or whether it's doing things at auction that we think are responsible and appropriate, we think that we always want to make those investments with the sustainability of the business.

If there were to be a spectrum reordering for whatever reason, either from auction or asset changes or whatever would we be -- we understand it, want to understand if there's elements of that, that are more effective than us putting capital into the network to build density and those types of things, we'll continue to evaluate that and make appropriate decisions as we can moving forward.

And it's -- I'm not going to go into the details of how we think about what the scenarios are and what we can play out, but you can guess that given the amount of money that's involved in it and the importance to the business, that we're constantly evaluating those things and determining what scenarios might play out, what we might do and what makes sense for the company.

Operator

And our next question comes from the line of Frank Louthan with Raymond James.

Frank Garrett Louthan - *Raymond James & Associates, Inc., Research Division - MD of Equity Research*

Can you characterize the threshold that you have to hit for FirstNet to remain within the government guidelines, will be the first question. The second was sort of excluding the 30 million homes surpassing with fiber and excluding California, what percentage of the rest of your footprint are you free from a regulatory perspective to replace the copper with fixed wireless or some form or something else like that?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Frank, would you maybe clarify for me when you say government guidelines, exactly what you're alluding to in that question?

Frank Garrett Louthan - *Raymond James & Associates, Inc., Research Division - MD of Equity Research*

I was under the impression there was a certain number of subscribers needed to hit for the FirstNet over a certain time period. Just curious where you are on that relative to the number of subscribers you have in the network today?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

I just wanted to make sure I was answering your question in a straightforward fashion. We -- I would tell you we are in really good shape. We're kind of through, what I would call, the first set of milestones that frame the first 7 years of the contract, and we've ticked through all those responsibilities and obligations as expected, and there's nothing there that's a problem or anything alerting. In fact, broadly speaking, I think we've performed incredibly well. And my -- I don't want to speak on behalf of the FirstNet authority, but I think both parties feel like it's been a very productive public-private partnership, and we continue to plan for what we can do in the future to extend it in other ways and do big things with it.

So on the rest of the footprint, California is really kind of the outlier. We have freedom from our carrier of last resort, obligations in virtually every other territory we operate in. How that gets done is a little bit different in each territory, but we have the latitude to do what we need to do. We've been doing a lot of work, and this is one reason we're at the filing stage in California on ensuring that we have to catch products to be able to support customers. And I'm really pleased with where we are. You obviously know what we can do with data services on the wireless network with fixed wireless. I talked about that just a few minutes ago as to where we are in the market and our ability to be there.

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But we've also been putting in place a scaled wireline replacement for basic phone service that has all the same features and characteristics and meets the regulatory criteria of what has traditionally been copper-fed pot services that we can support off the wireless network today. And those are 2 examples, there's more that are necessary, but 2 examples of replacement products that are better suited to play into our forward-looking architecture, which is a scaled wireless network than to serve off low-speed services, like copper.

And we feel like those are really, really good products. In fact, in many instances, offer a customer better benefits than what they get today. And I think regulators are interested. As we are doing all the right things to move forward, they don't want power-consumptive copper out there adding to greenhouse gases. They don't want people on technology that was built 100 years ago that fails when it rains. And so I feel like we're in a very good place to be able to do what we need to do.

Operator

And our next question comes from the line of Walter Piecyk with LightShed Partners.

Walter Paul Piecyk - *LightShed Partners, LLC - Partner & TMT Analyst*

John, AT&T played a pretty critical role when smartphones, I mean, specifically the iPhone, was rolled out, less so, I think, probably with tablets. There's been a lot of buzz about augmented reality as kind of the next device. I'm just curious what your thoughts are on like what an operator -- wireless operators role will be. Have you had any initial discussions on how those relationships would work with the number of device makers out there?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Walt, the answer is, look, I think all wireless providers are going to be instrumental to making this happen. And I believe you've heard me talk about the reality is 5G becomes pervasive and actually operates in the way 5G was intended to operate from a design perspective, which is you have the kind of ubiquity and the radio layer that's out there. You have actually the additional spectrum that gives you the right level of performance as 5G stand-alone cores are perfected so that they work the way they were intended to work, which, as with any new technology, that's been a little bit of a journey to get them to actually operate in the right way with the radio access layer given the complexity of the radio access layer in the United States, things like augmented reality are going to, in fact, become the opportunity of what are the new services that can come in place.

And I don't think it's going to be unique to AT&T. I think our competitors are going to do the same thing, and we're all building networks that are capable of supporting that. And we will, as we have in the past, probably be one of the types of channels that help distribute these additional devices that people ultimately will use in new ways. And more than likely, they're going to be things that are nice add-ons to family plans. And as I talked about, the reality of usage going up on these networks and why it's so important to have a fixed cost structure, these are the kind of things that I think are really, really important.

Because if you're in a variable dynamic and all of a sudden the new device shows up and becomes part of the family plan that drives another couple gigabits of usage and you're paying on a variable basis, that's not going to be a comfortable place to be when the realities of the next generation of applications come in 5G. And I expect that's going to happen. You -- I know you do a lot of homework, you know what the manufacturers are working on right now. We know what the manufacturers are working on right now, and we know when they're likely to come about, they're going to come about when these networks are scaled. The networks are going to be scaled as we exit this year. And I think you're going to start to see the new application to start to pop up as a result of that.

Walter Paul Piecyk - *LightShed Partners, LLC - Partner & TMT Analyst*

I also just have a follow-on question on the structure of the industry. I mean cable is obviously, in many cases, giving away free phones and then just reallocating revenue from the broadband business. And they've had success, I think, in terms of subs, maybe not at higher ARPU, but how do

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you see AT&T position long term in terms of also taking advantage of a bundled approach of offering broadband and mobile on -- in more markets than where you just have your fiber?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Well, we use the term durable wall for a reason, which is I don't want to just -- I don't want to spend empty calories for something that 18 months from now or 24 months from now, just looks like a (inaudible). And I'm trying to keep the business focused on doing the things that are the hard things that position the infrastructure for the next decade. And so I've been pretty consistent in my remarks, which is there are going to be places in our network where we have underutilized capacity and I don't have fixed infrastructure, and there's going to be segments where that underutilized capacity can best be used where it's durable.

I mentioned earlier in the call, there are many businesses that have usage profiles where I believe fixed wireless bundled in with other wireless services is a very durable offer, and it will be durable for a long period of time to come. There are certain consumer segments where that's durable, but it's not most consumer segments, in my view. And so we will continue to take advantage of that, where I have confidence that the customer acquisition cost will be worth maintaining the relationship with the customer and will sustain itself.

I just -- we were looking at our fiber in-service lines, for example, what's going on right now, and our fiber in-service lines are extending over our traditional copper and service lines because it's a great product and people want to keep it. And I know what those in-service lines are. And I know how long people keep that product in service. And the great thing is, when they hold it for 4.5, 5 years, I can scale the product over that period of time, and it's highly profitable. And we need to think about every customer we bring on in that regard, and we're being very diligent in how we allocate our customer investment and our network infrastructure and our capital infrastructure in a way that we're trying to bring on those durable relationships.

Again, I would point you back to the churn numbers that we've been putting up on both product sets, and we're trying to be true to that in what we're doing. And to the extent that you do that to subscription base, it plays out well for you over time. And it's just about being deliberate and disciplined in making sure that happens.

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

Thanks very much. I think that's all the time we have for questions. John, I'll turn it over to you for final remarks.

John T. Stankey - *AT&T Inc. - CEO, President & Director*

So I appreciate everybody joining us this quarter. From my point of view, it was a solid quarter that set us off on the right path to deliver to you what we've committed for this year. We are focused on something very, very basic. It's executing in our markets while we're continuing to restructure the cost of the business, and position our infrastructure for the future, as I just wrapped up with what I said with Walt.

And I feel really good about the way we're able to do that. In many respects, I kind of look at what we did operationally this quarter, and I characterize it as uneventful. And as we talk about with the management team right now having a few uneventful things occur when we get to call the plays and operate and execute in the fashion that we designed is absolutely what we want to achieve as a management team, as a company and I feel like we're making strides to do that.

Thanks for being with us today. I hope you all have a good rest of the spring.

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Operator

And ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T conferencing service. You may now disconnect.

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