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EDITED TRANSCRIPT

T.N - Q3 2021 AT&T Inc Earnings Call

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OVERVIEW:

Co. reported 3Q21 YoverY revenue growth (excluding DIRECTV revenues) of 5% and adjusted EPS of $0.87. Expects full-year 2021 adjusted EPS to be at high end of previous guidance of low-to-mid single-digit growth range.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to AT&T's Third Quarter 2021 Earnings Call. (Operator Instructions) And as a reminder, this conference is being recorded. I would now like to turn the conference 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 third 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. Also joining us for the Q&A portion of our call are Jeff McElfresh, the CEO of our Communications Group; and Jason Kilar, CEO for WarnerMedia.

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 is available on the Investor Relations website. And as always, our earnings materials are on our website.

I also want to remind you that we are in the quiet period for the FCC Spectrum Auction 110. So unfortunately, we can't answer questions about that today.

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

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

Thanks, Amir. Good morning, everyone. Thanks for joining us. I'll be brief because the quarter is largely more of the same. This marks the fifth consecutive quarter of consistent progress since we articulated our simplified business strategy and how we plan to measure our progress going forward.

The close of the DIRECTV transaction this quarter is another important step we've completed to reposition AT&T. I acknowledge, this makes for some extra cycles on comparative analysis. And as we continue to do so, there will be fewer moving parts to assess in better visibility and clarity.In the meantime, it's important not to lose sight of the success we're having, deploying capital into our areas of strategic focus. Bottom line, we're accelerating our historical rates of customer growth in Mobility, Fiber and HBO Max, and customer satisfaction is improving across the board with lower churn and higher NPS scores.

Mobility is delivering more postpaid phone customers on a rolling 12-month run rate than it has in the prior decade. Our Fiber products are recognized as best-in-class. As we expand our Fiber footprint, we're delivering a superior service and we're growing our share. We're already nearing the low end of our 2021 guidance for global HBO Max and HBO subscribers, despite our long planned intent to no longer seed customer control through Amazon's channels offering. Additionally, customer growth can be attributed in part to our ability to mine out significant cost savings from our operations and reinvest them back into the business. The results are driving Mobility and Consumer Wireline EBITDA growth that we expect to be complemented by margin expansion as our transformation work matures.

We have clear line of sight to achieving at least half of our $6 billion cost savings run rate target by the end of this year, driven by success with a number of initiatives that we believe also will support improving returns in the coming years. Whether they stem from nearly $1 billion of savings from streamlining our field operations, a similar level of savings from changes made to our procurement processes or $0.5 billion of savings from the rationalization of our retail store footprint, our focus on driving out inefficiencies is showing tangible results. These are just a few of the most significant programs underway. More initiatives that we expect will drive incremental savings and operating leverage are in the investment and implementation phase.

Finally, as I mentioned, we've closed the DIRECTV transaction and continue to expect the WarnerMedia deal to close by midyear 2022. With these and other dispositions, we monetized or announced plans to monetize more than $55 billion of assets over the past year. The last 5 quarters have been a period of repositioning our business, while also delivering operational results, without repositioning nearing completion that will afford even more focus on continued execution and improved performance.

We're on track to reach our full year free cash flow guidance in the $26 billion range, and we expect to hit the high end of our adjusted EPS guidance. We're in the early innings of transforming the company and believe that we have significant opportunity ahead of us to expand share in our focus areas and drive better returns, including sustained earnings growth. We continue to strive to earn your confidence one quarter at a time, delivering operating performance and shows our momentum is real and sustainable.

Let me now turn it over to Pascal to discuss the details of the quarter. Pascal?

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

Thank you, John, and good morning, everyone. Before we get to our consolidated results, let's look at the progress in our market focus areas on Slide 5. As John mentioned, we continued our strong customer momentum in the third quarter with 928,000 postpaid phone net adds. That's ourbest net adds quarter in over 10 years. Customers like the strength of our network and our consistent, simple offers. Gross adds are up, churn is low, and we continue to take share and grow our customer base.

Our Fiber base also continues to expand. Broadband revenues grew by more than 7%, and we now have 5.7 million AT&T Fiber customers, with 3.4 million of them on 1-gig connections. And we saw a sequential growth in our Fiber net adds with most of those new to AT&T.

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Let's now look at our HBO Max/HBO global subscribers. As we said last quarter, most of the subscriber additions for the remainder of the year are expected to come from our lower ARPU international base. We've reached nearly 70 million global subscribers, thanks to growth in our international markets. As previously announced, domestic subscribers were down due to our proactive decision to shut down the Amazon wholesale platform. This was partially offset by new wholesale relationships.

Retail subscriber growth slowed down the timing of new content, but we expect retail subscriber growth to accelerate in the fourth quarter due to strong content slate. We have new seasons of success in the Curb Your Enthusiasm debuting, the return of Sex and the City as well as the much-anticipated premieres of Dune, King Richard and The Matrix: Resurrection. Given our upcoming content slate and expanding global footprint, we expect to end the year at the higher end of our year-end global subscriber target.

Now let's turn to Slide 6 for our consolidated financial results. The third quarter results reflect the closing of the DIRECTV transaction after the first month of the quarter. We're a smaller company today than we were at the beginning of the quarter, and that is reflected in our results. Excluding DIRECTV revenues, revenues were up about $1.7 billion or 5%, thanks to growth in our market-focused areas. Gains in Mobility, Warner Media and Consumer Wireline more than offset the clients in Business Wireline and from the disposition of other businesses.

Adjusted EPS for the quarter was $0.87. That's up more than 14% year-over-year. In addition to merger-amortization adjustments for the quarter, adjustments were made to exclude our proportionate share of DIRECTV intangible amortization, a gain on the sale of Playdemic and the an actuarial gain on benefit plans. When you exclude DIRECTV from both periods, adjusted EBITDA was up 3% year-over-year, mostly due to growth in Mobility and strong growth at WarnerMedia, reflecting partial recovery from the pandemic and the timing of sports costs.

Cash from operations came in at $9.9 billion for the quarter. Spending was up, both year-over-year and sequentially with CapEx of $4.7 billion and gross capital investments totaling $5.7 billion. Free cash flow was $5.2 billion, inclusive of year-over-year increases of $850 million in CapEx and $1.7 billion investment in WarnerMedia cash content. Year-to-date, our content investment has increased by more than $4 billion. Additionally, our leverage position also benefited from $10 billion in asset monetization in the quarter, including our DIRECTV-TPG transaction.

Let's now look at our segment operating results, starting with our Communication business on Slide 7. Our Mobility business continues to gain steam. Revenues were up 7% with service revenues growing 4.6%. Postpaid phone churn remained at record low levels, and we had record postpaid phone growth. Prepaid also continued to be a solid performer for us, especially our Cricket brand. We added 249,000 prepaid phones in the quarter. Prepaid phone churn is less than 3%, with Cricket churn even lower.

Mobility EBITDA is up nearly $300 million or 3.6% year-over-year, driven by growth in service revenues and transformation savings. We expect that growth to accelerate in the fourth quarter. This growth came even with increased volumes, 3G shutdown costs of nearly $200 million, higher costs associated with the return of the iPhone launch into the third quarter and without a material return in international roaming. We expect similar quarterly 3G shutdown costs through the first quarter of 2022.

Business Wireline continues to deliver consistent margins in the high 30s and solid EBITDA. The business did see some difficult year-over-year comparison, given pandemic-related benefits experienced last year. We have been very aggressive in proactively rationalizing our portfolio of low-margin products. This creates incremental pressure on our near-term revenues. But at the same time, it allows us to focus on our core network and transport services products. It will take several quarters for us to work through this initiative. But as we lap the beginning of this process that began late last year, we should see improving revenue trends in Business Wireline.

Our Fiber growth was solid. We had our highest Fiber gross adds ever, and we continue to win share wherever we have fiber. We added 289,000 Fiber customers in the quarter, and more than 70% of Fiber net adds are new AT&T broadband customers, and this gives us great confidence aswe continue to build out our fiber footprint.

Last quarter, we reached a major inflection point in our Consumer Wireline business, where broadband revenue growth now surpasses legacy declines. Total Consumer Wireline revenues are up again this quarter, growing 3.4%. This quarter also reached an inflection point on broadband profit as EBITDA grew 3.8%. We expect sequential EBITDA growth in the fourth quarter, but it will be a tougher year-over-year comparison due toa onetime pandemic-related benefit in last year's fourth quarter.

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Let's move to WarnerMedia results, which are on Slide 8. WarnerMedia revenues were up 14%, led by strong DTC growth and content licensing. Direct-to-Consumer subscription revenues grew about 25%, reflecting the continued success of HBO Max. Content and other revenues were up 32%, reflecting higher TV licensing and the recovery of TV production and theatrical releases.

Advertising revenues were down nearly 12%, mostly due to the timing of sports. You may recall that the prior year third quarter included the restart of the NBA Season and the playoffs, which returned to a more traditional schedule this year. This lowered sports cost in the quarter, which helped WarnerMedia grow EBITDA by 13.5%.

The third quarter also included the impact of more than $200 million in DIRECTV advertising revenue sharing costs. With the close of the DIRECTV transaction, WarnerMedia continues to represent and sell DIRECTV's advertising inventory and now compensates DIRECTV through a revenue-share arrangement. This revenue share is now recorded as an expense to WarnerMedia.

We launched HBO Max in Latin America late June and have had incredible success. And next week, we are launching new international markets in Spain and the Nordic region, with more new markets to come in 2022.

Now before we get to your questions, just a few words about guidance. 3 quarters into the year, we feel good about customer momentum and where we stand relative to our guidance provided last quarter. With our strong performance, we now expect full year adjusted EPS to be at the high end of our previous guidance of low- to mid-single-digit growth range. And that's with significant costs expected to be incurred in launchingHBO Max in Europe. Additionally, we expect more than $350 million of advertising sharing costs associated with WarnerMedia's new advertisingsharing arrangement with DIRECTV as well as continued costs associated with shutting down our 3G network.

Also keep in mind, last year's fourth quarter benefited from the advertising associated with the U.S. presidential election. And as mentioned earlier, we are on track with our free cash flow target of around $26 billion as well.

In addition to the fourth quarter being a traditionally stronger free cash flow quarter, we expect the FirstNet reimbursement of approximately $1 billion, lower year-over-year cost from the iPhone launch moving up to the third quarter this year and DIRECTV cash distribution of approximately $800 million.

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.

QUESTIONS AND ANSWERS

Operator

And our first question today 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. With the inflection in the consumer market, the business segment is clearly what's keeping the communications business from generating positive EBITDA. And I know you guys had some tough comps. And Pascal, thanks for the comments on the revenue growth improvement. But when can we see -- start to see some EBITDA improvement? Any sort of color or granularity you can give there that get us to the point where the Communications business is growing EBITDA?

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And then maybe for Jason, can you give us any color on the AVOD launch this summer? And it looks like you guys added 6 million to 7 million HBO Max subs globally, if you net out the Amazon losses. Is that -- a, is that in the ballpark; and b, does the content release schedule that you guys mentioned, does it allow you to sort of build on that number as we go into the last quarter of the year?

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

John, let me start before Jason jumps in. Overall, here's the way to think about it. We haven't given specific guidance on the overall communications company yet, which is what I think you're asking about. But I said in my commentary that we expect Mobility, the biggest part of our business, to accelerate growth from here. I also said that, well, sequentially, we have some tough comps for the fourth quarter in Consumer Wireline, we expect sequential growth in that business.

Business Wireline, we talked about some of the issues we're facing. So when you think about all those things, you should get a sense that, from here, the momentum of the business continues, and we feel really good about it. Our customers are growing. Our revenues are growing, and we continue to take costs out of the business. So over time, it's going to translate to improvement in not only top line, but we will see profit growth.

Jason Kilar - *AT&T Inc. - CEO of WarnerMedia LLC*

John, I'll jump in. This is Jason on the AVOD question, which is we've been happy with the launch, which was in June of this year. So this is the first full quarter. And we're happy not just in terms of the absolute response, in terms of subscribers, but also because advertising helps lower the price and increase the value for an HBO Max subscription. So we see it as rather strategic, and we're very excited about where that goes.

One thing that is interesting to note, John, is that until the end of the year, there is a slight difference in the product of ad-supported HBO Max in that the movie, specifically Matrix, King Richard and Dune, are not part of the ad-supported offering. So there will be full content parity starting in late January of 2022. So we're very happy with the results, and we're quite excited about the future as well.

And then you also asked about our results. If you assume taking into account the Amazon Prime video channels exit, we haven't commented specifically on the size of the subscribers coming from Amazon Prime video channels. But I think it's safe to say that we're very happy with the quarter. When you think about how we've grown 1.9 million worldwide, and even when you think about the Amazon exit, which we think is a very strategic decision that 3 companies really have made so far, which includes Disney and Netflix being the other two, we feel very good about the quarter.

Operator

Our next question comes from the line of Phil Cusick with JPMorgan.

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

I wonder if you could talk on your view on the wireless industry. Clearly, your business, you've talked about is accelerating. But there's a thesis out there that there are huge subsidies in -- for consumers that are damaging industry health. Do you think investors are wrong on that and that the wireless industry is healthy? And with churn load, does it make sense to back off a bit on growth to push margin?

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Phil, this is Jeff. To address that question, I kind of back out for a second and look at the health of our Wireless business in the context of the overall industry and to tell you that our strategy is working here at AT&T. As we demonstrated, it's the fifth consecutive quarter where we have driven some momentum and gaining share. Our net add strength here in the quarter at 928,000. And that compares to what we have produced back in

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2019 in the third quarter of 101,000. And we're driving strong service revenue growth, and we just posted the largest total EBITDA that we've generated out of the Wireless business segment.

The best part about it, Phil, is that our customers are telling us that we're doing a good job. This churn levels that are low are a signal to the service and the value that we're offering. And our NPS feedback that we've received is the highest that we've ever received.

The sustainability of what we've done here in AT&T, I think, is really important to understand more broadly. It's a question that keeps coming up about our growth relative to competition in the general market. It's important to note that we've optimized our distribution channels. We've expanded the reach of it, and we're now addressing new segments that we were not addressing earlier, and that's helping us drive some of our customer momentum.

But in combination to that, Phil, we've simplified our rate plans, and we remain consistent in our offers to the market over the last 13 months, if you will. And this really enables the AT&T frontline team members to master their craft, deliver a higher level of service. And that -- this can't be overlooked. This is a key component to what's driving momentum for us at AT&T in our business.

I'd also point to things like our FirstNet program. We're starting to reach some scale here. Third quarter, we posted the highest net-add quarter since launching the program. And we've arrived at a position of leadership and strength in the law enforcement segment under that public safety sector. And so all in all, it's been the operational changes that we've made at AT&T that has driven really strong momentum in our customer counts.

The promotions that you referred to, there's an aspect of promotions that's just one element of this broader strategy. And it's important to note that not all of our customers that are with us, that upgrade or that join us from competitors, take advantage of the promotional offers that you seein the market. We've been at this for a little over a year now. And I can tell you that I've studied the characteristics of the customers that have takenthe promotion versus those that have not taken the promotion in our customer base.

And here's what I can tell you, that those that have participated in our promotional offers have a higher LTV, a better churn and a higher satisfaction score than those that have not. And so we know this is driving accretive value. The industry is healthy. And better than that, the new accounts to AT&T, those that are joining us from our competitors, they exhibit the same kind of characteristics in their financials, higher LTVs, better churn and higher satisfaction than our base.

So it's not just that we are adding more customers. We know, based on these metrics that we see, that we're adding high-value customers. And don't believe that this is driven uniquely by any kind of subsidy or extra cash flow that happens to be in the marketplace of the general market. It's also, I think, important, Phil, to note that the cost of these promotions as one element of our strategy, it runs through our service revenue. The cost of those promotions run through that in amortization. And so for us to be able suppose this kind of growth in the quarter in this competitive market and drive this kind of solid performance in subscriber revenue, accounting for any cost of the promotions, gives us confidence that we are accreting value. I would take this kind of quarter all day long in a competitive market, and I'm certain that our shareholders are going to be happy with it.

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

And Phil, I'd just add on that. We're not participating or taking EBB dollars on our postpaid subscribers. And I would say in terms of telecommunications, in general, and the health, there's clearly a stronger consumer out there because of some of the things that the federal government has done with the pandemic, the prop-up household income, and that's not -- can't last forever.

However, if you kind of examine where we are in the infrastructure bill, and you think about what is moving from a federal policy perspective on building better infrastructure, whether or not Congress gets that through, of course, is a question. But if you work under assumption that there seems to be some bipartisan view that we need to do the right things around infrastructure, and then broadband and connectivity to the Internet seems to come at the top of the list. I would expect that there's going to be some more federal money that moves into the industry next year. And some of it comes in the form of a direct subsidy to what's considered to be low-income households. That definition of low-income households isa fairly generous definition. It's 200% of the poverty line of the bill that was proposed or written.

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So when you start thinking about that, does that mean that a household, at least in terms of making decisions on telecommunications purchases, might be in a strong perspective next year? The economy continues to be reasonably strong. I don't worry about all of a sudden seeing a reversal or turn around the aggregate spending power on telecommunication services.

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

I appreciate the depth of your answer. I would only follow up. And Jeff, I think everybody has been pretty impressed with the results of AT&T over the last year. I would only follow up that the market is telling you that investors don't believe it, not necessarily about AT&T, but look at the stock price of AT&T, Verizon and T-Mobile together. And investors are discounting the terminal value of these companies pretty massively. And so more detail on that over time might be really helpful.

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

Well, I think our job is to do what we say we're going to do each quarter and continue to meet our commitments and carry it through. And ultimately, over time that when the cash shows up, it tends to get reflected in the stock price.

Operator

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

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

Thanks for the update on the WarnerMedia transaction. I wonder if you could give us a little bit more on when we might learn more at the final structure of the deal of the dividends policy, et cetera? Any color there would be great. And then on the supply chain, can you just revisit the fiber build pacing on the [2.5] million. And just general commentary on what you're seeing in the supply chain and how that's impacting both fiber and 5G rollouts.

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

Sure, Simon. So it's nice to hear you. Thanks for joining us today. The general progress on the deal, I think, is consistent with what we would have expected as we walked into it. As we indicated in our opening remarks, we're moving through the steps with the various regulatory agencies, both domestically in the U.S. and outside the U.S. Those processes are moving along at the pace we would have expected and don't see any surprises around it. As you might guess, regulatory agencies are doing their typical overview around that. And we feel really comfortable around the back and forth and what's been produced, the time lines and the milestones we've hit around those things.

I would not expect that we would be giving details around kind of our view of the construct of the deal until we're a little further along in that process, and we have some degree of visibility that we know that there's going to be a positive affirmation of the deal coming out. And we're getting into that, let's call it the window, where we know we're in the final back and forth to try to get either a consent decree or approval, whichever comes out of it, to get the transaction moving forward.

You probably have been around the deal long enough to know that we're not at that point right now, and we're probably not going to be at that point until we get into the early part of next year. And once we have some visibility around that and we can step back at that moment, look at where the stock price is, how things are standing in the market at that point in time, and we're starting to get down to that window where people would need to make a decision, then we'll be giving you some visibility around what we think the right path forward is around that. And obviously, we want to see what also transpires here in Washington over the next couple of months. There's chances that policy may change around how different types of distributions or different approaches get taxed. And all that has to be factored into our overall equation of how do we get value back into the shareholders' pocket in the right way. And the more information we have around that, the better informed that will be, and I think

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the better it will be for shareholders as they move through it. But of course, there'll be notice. before we close the transaction. I just wouldn't expect that it's going to be months and months and months before we close the transaction because we obviously want some degree of regulatory certainty.

And where we are with the build, what the first thing I would probably share with everybody is, we're on this path to substantially increase our fiber footprint. And that stretches across both our consumer and our business base. And I think as you've known from past history, this is -- it's not uncommon for us to go through these ramps of infrastructure builds. We've done it many times before. We've recently been through one where we went through a multiyear ramp on fiber builds that we kind of started executing around the 2015 time frame. They always, as you move through the front end of them, have a few moments where they're a little bit lumpy and a little bit rocky because that's the nature of it. These are inherently large civil construction projects, and they're spread out across many municipalities. And there's many permitting agencies and all kinds of things that go on in getting everybody kind of ginned up and ready to go at scale, sometimes take some steps. But at the end of the day, we always get there.

And I think what's important for the investors to understand is we're on this march to get ourselves into a position where we can deploy fiber at scale and move from where we are right now, which is we won an objective of about 3 million passings a year, and we'll ultimately probably ramp that into 5. But we're looking at other options to see if there's capital efficient ways for us to even take that up a little bit further and do more, but we will get there. And I would ask that we probably not rotate on any given 90-day period as to whether or not it was a good 90 days or a bad 90 days. It's a question around whether or not we scale this up and get to the point that we're starting to deliver new homes into the inventory in a regular fashion. And I'm absolutely convinced that the organization is doing that.

Are we seeing some supply stress right now in certain places as part of the reason why we guided down to 2.5 million this year? The answer to that is yes. It's coming in interesting places. But the great news is when you're the scale player in the market, we work through those faster and with the preferred position than others. And we're seeing that occur, whether it's chipsets for gateways and homes that are necessary to put a WiFi infrastructure and a modem in place. Or it's fiber components that are necessary or access to civil engineering, I think we're working through all those in a respectable fashion.

I can give you an example right now. One of the reasons that we had to kind of deal with a guide down was one of our fiber providers was struggling a little bit and getting us the prefabricated portions of the infrastructure that go out into the distribution plan, the last mile, if you will, the parts that go up and down alleys and streets that ultimately connect homes into the network. And there's preassembled components that come in that are pretty spliced, that are put out into the network as we receive them from the manufacturer. We have worked through a lot of those issues, andwe, in fact, have an awful lot of that infrastructure, if not all of the 2.5 million that will be placed.

But there is a connector piece of that infrastructure that moves from the optical node that ultimately ties that into the distribution neighborhood, which we're running a little bit short on right now. And it's literally a very small section of fiber that splices in the larger distribution. It's frankly the larger distribution that's harder to deploy. There's more labor hours in it. It's what requires more permits and more activity out in neighborhoods, but it's that little connector piece, and we're a little bit short on right now. We're working through with the manufacturer in a collaborative way. We have a lot of plans in place to get that done and get the work completed. But it's one of those things where it's going to be nip and tuck rightup until the end of everything we put in.

But if for some reason, we fall a little short on that, we're not talking about missing the substantial portion of the labor. We're talking about missing a connector that has to be put in that can bring up a lot of houses every time we put 1 more of those in on the network. So we feel good about the ramp. We're going to continue to ramp, and we're going to continue to give you insights to the new homes that are coming in. And we also believe, we're in a very unique position, given that we're the largest provider and builder of fiber out there right now that we're in strength in the industry and what we can command in that supply chain, and we've secured the right kind of relationships to get that done.

Operator

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

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

And 2 more for Jason. So last month at our Communicopia Conference, David Zaslav indicated that they would likely be taking a bit of a more targeted approach to deploying Discovery+ ahead of the merger closing. I'm curious, have you or do you intend to modify the rollout or go-to-market plans on HBO Max ahead of the merger? And if so, can you give us an example of what that means? I guess I'm just curious whether the current run rate of subscriber growth might actually understate the underlying momentum of the business, if you were going to market the way you would expect after the merger.

And then the second question is, you're nearly a year into this day-and-date strategy with HBO Max and theaters. I'm curious, what you've learned maybe the biggest surprise. And then more broadly, how has this experience shape your view on the role of theatrical distribution in sort of a post-COVID DTC-driven world?

Jason Kilar - *AT&T Inc. - CEO of WarnerMedia LLC*

Sure thing, Brett. I very much appreciate the questions. In terms of your first question, our approach is consistent with what our approach was a quarter ago, 2 quarters ago, 3 quarters ago. And what I mean by that is that, for us, it's business as usual. We're going to be launching in 6 countries next week in Europe, and we're very excited about that. And we've also publicly announced a number of other European country launches in 2022. So our approach is very much what it had been before. And we're excited, if you take a look at the Latin America results, what expansion across the globe can bring.

In terms of your second question about our motion picture slate and what have we learned. I'll state the obvious, which is not unique to us, is that we're in the middle of a pandemic, and a pandemic obviously presents very unique circumstances. And as you know well, we have been very much leading in the first over the wall, so to speak, in terms of bringing our 2021 slate to customers in a way that can work for them, but also work for exhibition and work for our participants. And so what we've learned is that motion pictures continue to matter. We believe they're going to matter for decades to come, and we're proudly investing in them.

In terms of the road forward, we've committed to 2022, and that's the visibility that we have. And that is a combination of 2 things. On one side will be a certain slate of motion pictures that will have an exclusive theatrical run, 45 days. That's quite a bit different from where things were, say, 5 years ago in terms of the theatrical run, then they will come to HBO Max. And then we're also going to have a slate of motion pictures from Warner Bros. that will come directly to HBO Max on Day 1. So that's -- those are the answers to your 2 questions, Brett. Thank you for asking.

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

Brett, if I put an exclamation point on your first question, which is we absolutely believe and did this transaction with the notion that we're moving this business forward in a Direct-to-Consumer marketplace. And it's required that you get to scale, and I've said multiple times that run a window here where that's a foot race, and it's an important foot race. So there's no pulling the foot off the accelerator in that regard. It is -- HBO Max is the foundation of that business moving forward and how the combined company will continue to go to market. And everything that we do right now to make that product better and add customers is a step in the right direction and the consistent direction of where the closed and combined business goes. And we all want the shareholders that own a substantial portion of that company moving forward to have a valuable asset, one that's growing and one that will be successful in the next generation of media. And we believe we've got to do the right things right now to make sure that the business is well-positioned to make that happen.

Operator

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

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

Two, if I could. The first one, Pascal, I think, for you. The way that the industry is growing ARPU has been moving meter plans to unlimited, unlimited to premium unlimited. You called out that now that we're at the end of year 1 of the promotional retention discounts that you guys are offering, the amortization of those discounts and ARPU is starting to be felt in a 60 basis point year-over-year decline. Can you kind of give us a feeling for how we should expect these 2 forces to work against one another as year 2 and year 3 see these promotional discounts compound as a headwind, assuming you continue down this path? And the runway you have to try to offset that with core growth, recognizing, of course, that it's just an accounting issue.

And then the second question would be, you mentioned that you've taken a year's worth of initiatives to try to improve the business revenue trajectory. Could you kind of give us a picture of kind of what has happened? And what kind of change do you expect to see in the business outlook?

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

So Dave, on the latter question, you're talking about Business Wireline?

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

Correct.

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

Okay. Let me start, and Jeff will probably chime in on a few items. Remember, as we've said, the promotions that we are doing, one, not all customers are taking them. So that's a big factor to keep in mind. Two, yes, the amortization is growing, but the ARPU, the cash ARPU is there. And when you couple the increase -- the continued vibrant cash ARPU with the expense work that we are doing in the middle of the P&L, we expect to grow both top line and bottom line as we move forward. And yes, there will be some slight degradation in ARPU. But when you look at our overall ARPU, we're still at the high end of the industry. So that's a consideration to keep in mind. These are very profitable lifetime value subscribers.

As it relates to Business Wireline. We started about a year ago, starting to rationalize low-profit margin products and services. And that effort continues. The goal would be, over time, more and more of our services in the enterprise space are going to come from our core connectivity product, whether it be wireless or fiber. And that's where the growth is going to come. And it's a process we are partway through, but we think as you get through the latter part of this year to early next year, the comps get a little bit easier. I'll ask Jeff to chime in.

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Yes. Thanks, Pascal. If you look at our Business Wireline business, as we reported segment-wise, we are moving customers, many of our enterprise customers through a product mix shift. We've been doing this for a while. I think it's important to note that, unlike others, we don't report a consolidated business P&L that includes wireless. And we are actually seeing shift to wireless for many services as many of our customers have moved off and over in the pandemic. That's just a general observation.

More specifically, David, the 3 parts of our business that we're getting to subscriber growth, revenue growth and then EBITDA growth, we've got first two, our business -- our Consumer Wireline and our Mobility moving in that direction. And we are at the cusp of getting our Business Wireline business to move in that direction. It's going to take some time because it's going to require some product mix and product development work, specifically areas of the business markets that we, at AT&T, serve less were underrepresented or more of the medium-sized businesses in the mid-market. And these customers are more inclined to use shared broadband served up by fiber and our business service -- class services that we sell to our top-end enterprise accounts are a bit more bespoke and specific networking networks that are not necessarily attractive to the mid-markets. We have been making moves to shift the product mix in demand.

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And as John mentioned earlier, as our fiber expansion, that's not just for consumer but also for business, begins to take footing, you'll see us shift shares of our revenue in Business Wireline more transactional-based and down market with the execution that we know we can deliver. And so it's going to take a few quarters as we work through it. The cost transformation that we're undertaking inside the Communications company, as Pascal mentioned, we're about halfway through the $6 billion in aggregate for the firm. The back half of the transformation program really bringsin more operating efficiencies in our Business Wireline segment that we'll see start to accrete to EBITDA growth in that part of our business.

Operator

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

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

Just wanted to follow-up, and forgive me if you mentioned a little of this earlier, but I just wanted to unpack this a little bit further. In terms of the Wireless business, what you're seeing in terms of the rate in participation for unlimited plans and the higher value plans? And how much opportunity is in front of the company to upsell customers on these higher value plans that you've been marketing?

And then just secondly, back in -- I think it was March at the Analyst Day, AT&T set a goal for net debt to end the year at $154 billion at 3x leverage, which infers if you just divide the 3 into the net debt. It's about $51.3 billion of EBITDA ex-DTV for the year. And since then, it seems like your cost-cutting program is moving faster. So just curious if you can give us an update on these goals? And is that the right bouncing-off point to think about the AT&T EBITDA without DIRECTV for 2021?

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Mike, I'll take the first part of your question. This is Jeff. There still remains a large opportunity within our base of customers to work them through a more value, higher end of our rate plans. And you're kind of seeing that play out in postpaid phone ARPU. Pascal touched on this a second ago. If you think about maintaining the industry-leading, the highest ARPU of any player in the market, even though we're the third player in wireless, being able to do that with some of these promotional offers that are part of our strategy, gives us confidence that we're working our base and our customers up the ARPU stack into higher-value unlimited rate plans.

We still have large portions of our subscriber base that we have not migrated into those rate plans. And so we expect that to continue pretty much on the course and speed of what the customer wants. We're not driving or forcing any unnatural behavior there. We're letting the customers choose when it's time for them to take advantage of an offer or to move into a new rate plan, and we'll continue to execute that. So that's got room to run for the next many several quarters. That's not something that's going to dry up in the short term.

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

Mike, a couple of things to keep in mind. While we didn't -- we're not updating that guidance. We feel comfortable with it. If you want to get to a sense for what the base business is post-DTV and WarnerMedia, which I think all of the information is out there, we've provided -- for WarnerMedia, we report the results separately. So those are very easily discernible. And then if you look at DTV, we've provided extensive pro forma.

The thing to keep in mind is when we compute net debt-to-EBITDA, we use the trailing 12 months. In this instance, some of it included DTV for part of the year, and it doesn't include DTV for another part of the year. So that's how you're getting to your 3x. That's how we get to 3x in the guidance we provided. But other than that, we're not changing the guidance. We think that should get you in the zone. And if you have any further questions, I'm sure the IR team can walk you through it.

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Operator

And our next question comes from the line of Kannan Venkateshwar from Barclays.

Kannan Venkateshwar - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

So I guess if I could just dig into the Fiber business a little bit more. Is there any change in terms of the go-to-market strategy? I think you guys tweaked the pricing plans, if I'm not wrong, during Q3. But more broadly, if you could give us some color around what part of this origination also includes bundles with Wireless? And the acceleration in growth in fiber, you guys have been building out fiber for a while as a part of the DTV deal, and some of that was overlapped with your DSL footprint. But in that overlap, you did not seem to get the same kind of success that you are getting right now. So if you could just expand on the differences in go-to-market as well as the customer cohorts that you're targeting and how you expect that to evolve, that will be useful.

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Kannan, it's Jeff. What has been our difference in go-to-market strategy? We are executing at a faster pace in this build than we did in the prior build. Our -- in fact, the gross additions that we had in our Fiber business in the third quarter, roughly around 500,000 highest ever.

Our network engineering teams are getting the fiber late into the ground, into customer homes in a cycle time. That's about 30% faster than our prior build. And our marketing organization is tactically out in the markets, driving early 30-, 60-, 90-day (inaudible) rates at 2x the levels that we saw in the prior build. We are absolutely including wireless as a bundled opportunity for us in this part of our footprint. And I'd cite that about 7out of 10 additions to our fiber network in this last quarter were new accounts to AT&T and, therefore, give us an opportunity to go drive Mobility growth as well in the footprints where we built it.

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

And I'd just maybe emphasize something Jeff said and maybe will quibble a little bit with your characterization of the previous success on the "last build". There was really not much new fiber build from about 2018. At the end of 2018, for -- there's a bit of a hiatus period there. So I would tell you that a lot of the results you're seeing right now, to Jeff's point, is really better execution of the team going back in and working in some of the asset base to actually improve performance overall.

Yes, now the midpoint of this year, you're now seeing some new inventory come into play, and we're getting a lot better, as Jeff just described, moving through penetration rates faster. And if we, in fact, sustain that, it's going to make the business case even a stronger business case because one of the big sensitivities to payback is rate to penetration. And if we can keep that going, it can be dramatically better than what we think is already a pretty attractive business case.

And the last point I would make is the nice part about this build in many instances is that we're filling in a little bit of areas that we maybe didn't complete previously. And so as that fill-in occurs, you get some effectiveness on marketing messages, the ability to go into a market and get your particular value proposition effectively communicated, how you deal with your distribution channels through that. So we'll probably be a little bit more effective and efficient given the base of customers that we have as we build out and fill in over the next several quarters.

Kannan Venkateshwar - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

Got it. Can I just follow up? I mean in terms of your go-to-market strategy in wireless, the device promotions obviously helped quite a bit over the course of the last year. When we look at the broadband side of the business, the current pricing structure and the promotional structure that you have, should we basically think of that as the operating steady state? Or you're thinking more broadly about potentially a different kind of pricing and promotional structure to accelerate this growth?

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Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Kannan, right now, given the demand that we have for this best-in-class product, that's 4.5x better than our nearest competitor, and the quality of the products and the value that we offer to the market, we like the demand that we're generating. This business is about getting fiber built as quickly as we can to serve these customers, to give them gigabit level speeds at a really solid price point. So I wouldn't anticipate any change or moves so long as our offer in the market continues to gain customers.

Operator

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 walk us through your fixed wireless strategy? And what percentage of the demand do you think that product comes from enterprises versus consumer? And then also curious on the outlook for wholesale on wireless. You potentially lose some share, I guess, with TracFone over time. But what about wholesale deals with other LEC or things like that to try and [boost] that business?

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Frank, it's Jeff. Right now for our Broadband business, as you know, we're focused on fiber, but we do offer some fixed wireless services. And it's predominantly focused today in the enterprise segment, where most of those clients are looking for a 4G or 5G wireless backhaul. We are experimenting as is everyone else in leveraging our scaled wireless network to maybe augment pockets and areas with some fixed wireless, but it honestly is not a lead product for us. And we won't make that top of the funnel for our broadband services. Your second part of the question was what, Frank?

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

On the wholesale side in wireless, you potentially lose some share over time with the TracFone deal. And what are your thoughts on growing that business, possibly offering wholesale deals to other smaller LECs that are building broadband and so forth to kind of boost that wholesale revenue over time?

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Well, for sure, all of our network assets, we're looking to maximize the yield. And because of the investments that we've made in wireless, Frank, we've got ample capacity sitting inside of our broad network architecture or infrastructure. And so akin to what we have announced previously with DISH, which by the way, is operationally up and running, we've successfully integrated our systems with the DISH systems and now providing connections into their distribution network. And we're going to look to ramp that MVNO offering for DISH over the course of the '22 and beyond.

I'll remind you, that's 10-year deals is long term. And so based on that move, you should expect that we are interested in serving all forms of traffic so long as they are accretive to our share owners and to our business. And I would expect, you'll see us as a participant in that.

If you look also -- one last comment, Frank. If you look at historically, we've been pretty underrepresented in retail or wholesale in our run rates of our business. And so it's been an area of focus for the team, and we'll look to grow that line in our business.

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Operator

And that last question will be coming from the line of Colby Synesael with Cowen.

Colby Alexander Synesael - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

I just wanted to follow up on the $6 billion cost-reduction initiative. How long will it take to achieve the back half of that goal? Secondly, would you expect this to actually result in margin accretion? Or will the majority of this be reinvested? And then, I guess, third on that, what segments are we really going to see that show up in the -- you mentioned, I think, Business Wireline, but is there any others that will be fairly material as well?

And just real quickly, John, in one of your comments, you mentioned going from 3 million to 5 million homes passed per year with fiber. I, at least, hadn't heard that 5 million number before. Is that new? Or is that always there? And is that just simply intended to get you to catch up to get to that 30 million home passed long-term goal? Or is there an expectation that you're going to go well beyond that 30 million that you had previously mentioned?

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

Colby, I've been pretty clear from the front end of this. My view is our job is to execute and return to you results that you look at and say those are really impressive and that's great. And that the business, to the extent that we do that, I fully believe there's more opportunity for us to go out and continue to build infrastructure that's highly capable that can attract business. And I think my belief is that this management team, as we demonstrate in the market, we can do that.

Do I believe there's an opportunity for us as a company to operate at a 5 million a year range kind of at capacity and what we do. I think we can get there. How we get there and how we scale that and what time frame will be an artifact of what we come back to you and tell you in terms of our results and how much progress we're making around them. And we're going to continue to push forward. But as I work with the management team internally, it's kind of how I'm asking them to think about scaling up their business, running their business, sizing their business, creating vendor relationships that allow us to move that path. And that's the -- it's up to us to execute around that to get there.

The last -- I'll make a comment just on the other piece, and then turn it to Jeff to get to the bulk of it. We've given you guidance on cash flow for 2022, 2023. And there's obviously questions that many of you are asking, "Well, can they get to that level?" And you better believe some of the cost savings stuff is dropping to the bottom line because that's how we get to that level.

So the back end of this program, while we've used the front end of it to actually increase our market effectiveness and be in a better position in terms of our customer growth and volume, the back end of this program is about actually getting a better efficiency that drops to the bottom line that ultimately comes in play and helps us on the cash flow side. And I think that's how you should think about how we've kind of done that. And there's some structural approaches that we're using on the higher longer-term issues like changing out IT infrastructure and data structures, et cetera, that's harder and longer work, but tends to also have more operating leverage once it goes into service, and we get it done. And that's really what's underneath it. Jeff, why don't you go ahead and find any additional color you might want to add, I'm talking.

Jeffery Scott McElfresh - *AT&T Inc. - CEO of AT&T Communications LLC*

Yes. And it's not only impacting our Business Wireline part of the franchise, Colby. It's all 3 reported segments. I think we've been investing heavily in these transformation initiatives to go drive growth and improve our cost structure and our effectiveness as an organization. Simply put, we have been hard at work inside of the company preparing for a better execution and a better operating performance. And we're seeing signs of that in our Wireless business. We're seeing signs it is now in our Consumer Wireline business. And I'd tell you that the Business Wireline begins to feather in as we move into the back half of the program.

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

Okay. With that, first of all, thank you all for joining us this morning and appreciate your questions and your interest in the business. And as I said at the start of the call, I think in some respects, the quarter is more of the same. It's been consistent focus and consistent execution.

And I would say, I'm really pleased with our progress overall on how the team is executing. There are a lot of moving parts, and there have been some distractions, but I really am pleased across the board, whether in the Communications company and Media company. Teams have done a remarkable job that stay in focus on what their task is at hand. And I only get more excited about that because as we work our way through this process, and some of those distractions drop away, I think the sky is the limit in terms of what these teams can do with even better execution as they hit their stride around things.

The comment that Phil made, I guess, where I would come out on my point of view of these markets that we're involved in, as I'm actually much more bullish and optimistic about the markets in aggregate. I think there's a reason, there's a substantial amount of investment moving into these industries, and it's because there's a tremendous importance and an inherent value that customers get out of connectivity moving forward. And if I were to think about our businesses on the communications side of the company, we are moving into what I would call the golden age of connectivity and ubiquity and connectivity. I actually feel really optimistic about that, that there's some really smart operators in this industry.

They're investing because they have a path to gain return on those things, and they're going to do it in a way that's intelligent and smart. And demand is strong in these industries, and I believe there may be some structural changes that come out of some of the programs that the government is looking at that could make that demand even stronger and more robust. And I believe that if policy is structured appropriately in this country right now, we can see a really strong forward progress in the communications industry that's good for all of us.

On the media side, I think we are in a very, very unique position with what we've done. We set out, as we started HBO Max with a description of a product that we thought was going to be different, it was going to be a more focused product with a higher degree of quality and a more distinct brand characterization of what we did moving forward. I think if you go out and you look at any third party that's been evaluating that, as the team has gained its stride and continue to iterate on the quality of the product, the quality of the platform, as we move through the pandemic in terms of our ability to bring new content out, the market, ratings of engagement, viewership, awards that have come in, indications of time engaged on the platform from third parties have all been recognizing the team on that work.

And I absolutely believe it is a unique breed of cat that, when combined with Discovery moving forward, will only strengthen its capabilities to become one of the must-have platforms of consumers moving forward, and a tremendous amount of value creation as that customer base is established globally.

So with that, we'll talk to you as we wrap up the year. I expect to come back and tell you more of the same. And I hope you all have a great fourth quarter and great holidays if I don't talk to you before then.

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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These risks, as well as other risks associated with the proposed transaction, will be more fully discussed in the proxy statement/prospectus that will be included in the registration statements that will be filed with the SEC in connection with the proposed transaction. Discussions of additional risks and uncertainties are contained in AT&T's and Discovery's filings with the Securities and Exchange Commission. Neither AT&T nor Discovery is under any obligation, and each expressly disclaims any obligation, to update, alter, or otherwise revise any forward-looking statements, whether written or oral, that may be made from time to time, whether as a result of new information, future events, or otherwise. Persons reading this announcement are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof.

Additional Information and Where to Find It

This communication may be deemed to be solicitation material in respect of the proposed transaction between AT&T, Spinco, and Discovery. In connection with the proposed transaction, AT&T, Spinco and Discovery intend to file relevant materials with the Securities and Exchange Commission ("SEC"), including a registration statement on Form S-4 by Discovery that will contain a prospectus of Discovery and Spinco that also constitutes a proxy statement of Discovery, and a registration statement by Spinco. This communication is not a substitute for the registration statements, proxy statement/prospectus or any other document which AT&T, Spinco or Discovery may file with the SEC. STOCKHOLDERS OF AT&T AND DISCOVERY ARE URGED TO READ ALL RELEVANT DOCUMENTS FILED WITH THE SEC, INCLUDING THE REGISTRATION STATEMENT AND PROXY STATEMENT/PROSPECTUS, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTION. Investors and security holders will be able to obtain copies of the proxy statement/prospectus (when available) as well as other filings containing information about AT&T, Spinco and Discovery, without charge, at the SEC's website, http://www.sec.gov. Copies of documents filed with the SEC by AT&T or Spinco will be made available free of charge on

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AT&T's investor relations website at https://investors.att.com. Copies of documents filed with the SEC by Discovery will be made available free of charge on Discovery's investor relations website at https://ir.corporate.discovery.com/investor-relations.

No Offer or Solicitation

This communication is for informational purposes only and is not intended to and does not constitute an offer to sell, or the solicitation of an offer to subscribe for or buy, or a solicitation of any vote or approval in any jurisdiction, nor shall there be any sale, issuance or transfer of securities in any jurisdiction in which such offer, sale or solicitation would be unlawful, prior to registration or qualification under the securities laws of any such jurisdiction. No offer of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the Securities Act of 1933, as amended, and otherwise in accordance with applicable law.

Participants in Solicitation

AT&T and its directors and executive officers, and Discovery and its directors and executive officers, may be deemed to be participants in the solicitation of proxies from the holders of Discovery capital stock and/or the offering of Discovery securities in respect of the proposed transaction. Information about the directors and executive officers of AT&T is set forth in the proxy statement for AT&T's 2021 Annual Meeting of Stockholders, which was filed with the SEC on March 11, 2021. Information about the directors and executive officers of Discovery is set forth in the proxy statement for Discovery's 2021 Annual Meeting of Stockholders, which was filed with the SEC on April 30, 2021. Investors may obtain additional information regarding the interest of such participants by reading the proxy statement/prospectus regarding the proposed transaction when it becomes available.

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