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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Thank you for standing by. Welcome to AT&T's Third Quarter 2023 Earnings Call. (Operator Instructions) And as a reminder, this conference is being recorded. I would like to turn the conference call over to our host, Mr. Amir Rozwadowski, Senior Vice President of 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.

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. At the start of this year, we articulated a plan in which our deliberate investment in 5G and fiber would help grow our customer base in a profitable manner. Strong results we share today represent the latest proof that our strategy is working and sets us up for continued sustainable and profitable growth.

We're meeting rising data demand with best-in-class 5G and fiber solutions. This is not only expanding our durable customer base but also delivering attractive returns. The results we're seeing only strengthen our conviction in continuing to invest to bring these next-generation technologies to even more Americans. We're tracking in line to meet or beat our consolidated financial targets. And we're raising our full year adjusted EBITDA and

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free cash flow guidance today. Our goal has been to invest and grow the business in a manner that progressively differentiates the AT&T asset base in our industry, and we're doing exactly that.

In wireless, our consistent go-to-market approach continues to expand our base of high-value subscribers. Our results show that our best deal for everyone approach continues to resonate with customers. For example, in September, we saw the strongest iPhone preorders we've had in many years despite competing promotions with higher subsidies allowing lower-value device trade-ins. This is a testament to both the simplicity of our offers and the strength of our consistent and straightforward value proposition as well as the quality of our network.

The tale of the tape is clear. Customers are staying with us longer and spending more with us. Just take a look at our consistent low churn, increasing ARPUs and improving returns. Why? Because we're providing more value to customers. For example, the vast majority of people taking our iPhone promotions are signing up for our highest value plans even though it's not a promo requirement. In fact, our highest value unlimited plan is our fastest growing plan.

In addition, our network has never been better in terms of its size and quality as we continue to enhance the largest wireless network in North America and expand the nation's most reliable 5G network. It's no surprise that when you combine our high-value customer growth and rising revenues per user, we continue to grow profits in our wireless business as evidenced by our highest ever EBITDA on record.

Turning to fiber. The story remains the same. Where we build fiber, we win. We win by delivering the undisputed best broadband solution on the planet, improving our brand position, gaining broadband share and by improving our mobile share.

Our strategy is working. We just delivered nearly 300,000 high-quality net adds this quarter against a muted backdrop of household move activity. In addition, the returns on our fiber investment continued to improve from our initial assumptions. We're exceeding our expectations for penetration in new markets. Additionally, the accretive mix shift to higher-value fiber plans has driven our fiber ARPU up nearly 9% year-over-year. Look no further than how fiber is fueling a surge in broadband revenue growth.

Consumer Wireline has transformed from a declining business to one that is delivering strong, consistent growth. We offer a superior product that has room to improve on all the levers that drive margin performance as we scale. No matter where we put fiber, we're the preferred broadband provider. In August, we selectively launched AT&T Internet Air, our fixed wireless product. We view this service as yet another tool in our connectivity toolbox. While it will primarily act as a targeted catch product, we've been pleased with the positive early reception and have already added about 25,000 subscribers pushing us back into positive territory for overall net broadband growth of 15,000 subscribers in the quarter.

Meanwhile, we're only in the very early stages of reaping the long-term benefits from the inevitable convergence of 5G and fiber. Where we've deployed fiber, we're seeing a tick in Mobility growth. Additionally, AT&T customers with fiber and wireless service have our lowest churn and the highest lifetime values to match. As the one player scaling both wireless and fiber networks, we're well positioned to be the provider of choice for the ubiquitous connectivity that consumers want. And importantly, we're positioned to do this at the lowest unit economic costs, establishing a long runway for sustainable returns.

As we advance our network capabilities, we're powering experiences built for the high-speed connected everywhere world we now live in. One example is our work with Cisco to deliver the next evolution and collaboration for those working on the go. By tapping into the fast speeds and low latency of 5G, we seamlessly extended [web-in] calling capabilities to mobile phones, simplifying connectivity for a mobile workforce. We feel strongly that this is just the beginning of what's possible. At the same time that we're reinvigorating customer growth, we are also operating more efficiently across our business. This is a core component of the 120 basis point margin improvement we saw in adjusted EBITDA compared to the third quarter of 2022.

You can also see the benefits of our $1.5 billion of incremental cash from operations over the first 3 quarters compared to the same period a year ago. We're off to a strong start as we execute on our plan to generate $2 billion plus of incremental cost savings within the next 3 years, and we're confident in our ability to achieve this goal. We're executing our legacy wireline transformation as we scale our 5G and fiber networks. Over time, we expect this evolution to drive significant operating efficiencies as we sunset legacy infrastructure that no longer meets our customers' needs.

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We're also aligning our operating footprint and work environment to mirror our streamlining focus on 5G and fiber. These steps are important enablers to further improve our collaboration, eliminate organizational redundancies and fully utilize the innovative technologies that improve how we work. And while we're still in the very early stages of generative AI, we're already seeing tangible AI-driven improvements in productivity and cost savings. Measurable progress has been made with lowering customer support costs, unlocking software development efficiencies and improving our network design effectiveness. We expect these capabilities to play a key role in our continued efforts to achieve our future cost savings objectives.

This takes us to the final priority, and that's how we're putting our improving operating leverage to work. In the third quarter, we reduced our net debt by more than $3 billion and are on track to achieve our 2.5x net debt-to-adjusted EBITDA target by the first half of 2025. Less net debt allows us to continue investing in AT&T's durable connectivity businesses and enhance our ability to deliver additional shareholder returns, once we reach our long-term target.

Our focus remains steady on allocating capital to create best-in-class experiences for customers, drive sustainable, profitable growth and deliver long-term value for shareholders. Over the last few years, our investment-led strategy has delivered tangible benefits to and financial returns from our growing and high-value customer pool in both Mobility and broadband.

We've expanded our nationwide 5G network and are on track to reach 200 million people or more with mid-band 5G spectrum by the end of the year. We're also on track to pass 30 million-plus fiber locations by the end of 2025. We now have about 24 million fiber locations that we're able to serve on our network with additional opportunities to provide service through our GigaPower joint venture with BlackRock or BEAD funding opportunities. Given the returns we're seeing, we continue to believe leaning into attractive return profile of 5G in the fiber business makes strategic and economic sense. At the same time, we remain committed to our dividend payout level and expect its credit quality to consistently improve.

In fact, we've already generated more than enough cash to meet our annualized dividend even before the fourth quarter, which is generally our highest cash generation quarter. Demand for better and faster broadband connectivity has grown exponentially. With the largest wireless network in North America and as the nation's largest fiber Internet provider, we're providing best-in-class 5G and fiber services to meet that demand. It's clear the fundamentals of our business have never been stronger. They'll only grow stronger as we continue to scale our networks, simplify our customers' connected lives and deepen our engagement with them.

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

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

Thank you, John. Good morning, everyone. As John discussed, we're driving great returns on our 5G and fiber investments, as you can see on Slide 5. The favorable trend in our wireless and broadband businesses continue. We're growing subscribers, ARPUs and margins in both wireless and broadband, and we're taking out costs. Our strategy is working and gives us confidence to raise guidance today. I will discuss this in more detail later on.

Now let's move to our third quarter financial summary on Slide 6. Consolidated revenues were up 1% in the third quarter, largely driven by growth in wireless service and fiber revenues. These increases were partially offset by an expected decline in business wireline. Adjusted EBITDA was up 4.6% for the quarter with growth in Mobility, Consumer Wireline and Mexico. This was partially offset by an expected decrease in Business Wireline. In fact, due to our increased revenue growth and overachievement in cost savings, we now expect to grow adjusted EBITDA by better than 4% versus our prior guidance of 3% plus.

Adjusted EPS was $0.64 compared to $0.68 in the year-ago quarter. This includes about $0.08 of noncash aggregated EPS headwinds from lower pension credits, lower capitalized interest, higher effective tax rate and lower DIRECTV equity income, all of which we expected. Cash from operating activities was $10.3 billion in the quarter and $26.9 billion year-to-date. This is an increase of $1.5 billion year-to-date primarily driven by higher receipts due to revenue growth and lower disbursements, including personnel costs and device maintenance. This growth comes at the same time as we saw a lower year-over-year net impact of receivable sales of about $1 billion year-to-date and higher cash taxes of about $350 million year-to-date. This shows the underlying strength of the organic cash flow occurring in our business.

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Capital investment was $5.6 billion in the quarter. This reflects continued historically high levels of investments in 5G and fiber. We expect to move past elevated capital investment levels as we exit the year. We feel really good about free cash flow of $5.2 billion in the quarter. Through the first 3 quarters, our free cash flow was $10.4 billion, up $2.4 billion versus the same period a year ago. We're also now tracking to about $16.5 billion free cash flow for the full year.

Now let's turn to our Mobility results on the next slide. Looking at our Mobility results, postpaid phone net adds were 468,000. Total revenues and operating income in our largest business unit are at all-time highs. Revenues were up 2%, and service revenues were up 3.7%. These gains were driven by subscriber growth and higher postpaid phone ARPU. Year-to-date, wireless service revenues have grown 4.6%, and we continue to feel really good about the performance of our wireless business.

Mobility EBITDA was up 7.6% in the quarter. Mobility postpaid phone ARPU was $55.99, up $0.32 year-over-year. The primary drivers of ARPU growth are higher ARPUs on legacy plans, a continued mix shift to higher value rate plans with higher margin and continued improvement in consumer international roaming trends. Postpaid phone churn remains low at 0.79% for the quarter. This continued low wireless churn shows our value proposition is resonating with customers. In prepaid, we had 26,000 phone net additions with total churn of 2.78% with Cricket churn substantially lower.

Let's move to the next slide in our wireline results. Our fiber investment is driving Consumer Wireline growth and strong returns. We added 296,000 fiber customers in the quarter. The consistency of fiber's appeal continues to shine as we've now added more than 200,000 fiber net adds for 15 straight quarters. We've also seen measurable improvement in fiber churn year-over-year despite recent pricing actions. This highlights the superior product and experience that customers consistently receive with fiber. Strong fiber revenue growth of about 27% drove total broadband revenues up nearly 10% year-over-year. Fiber ARPU was $68.21, up about 9%. Customers are increasingly choosing faster speed tiers, which is also supporting ARPU growth.

Consumer Wireline EBITDA grew 9.4% on the strength of fiber revenue growth. Given the better-than-expected broadband revenue we've achieved so far this year, we now expect to deliver 7%-plus broadband revenue growth for the year. Additionally, our AT&T Internet Air product is off to a solid start. As we expand our service to select new markets, we're confident it will serve as a strong catch product as we continue to sunset our legacy copper services.

Turning to Business Wireline. EBITDA was down $268 million year-over-year. Overall, Business Wireline remains in transition as we move from offering legacy products to next-generation connectivity products. If you take a step back, the overall picture of our business franchise looks somewhat different when you include the increasing strategic importance of business wireless to these very same accounts. Wireless service revenue was up 7%, benefiting from continued growth in postpaid wireless subscribers and connected devices. As the transition to electric vehicles continues, we expect a tailwind from our consistent success in connected cars since EVs consume more data bandwidth.

Connectivity solutions are also growing in the high single digits due to momentum with fiber as we make it available for more small- to medium-sized businesses. And total business solutions year-to-date, EBITDA is down slightly year-over-year as growth in wireless is largely offsetting declines in wireline. At the end of the day, we see the same underlying trends we see year-to-date with Business Wireline EBITDA, and we now expect low double-digit declines for the full year.

Now before I close, I'd like to quickly provide an update on the progress we're making on improving the flexibility of our balance sheet. As a result of our strong cash generation, we're on track to achieve our net debt reduction target for the year. In addition to debt reduction and liability management we discussed last quarter, we have also incrementally reduced our short-term direct supplier and vendor financing obligations in the third quarter, and we expect to continue to do so in the fourth quarter.

As a reminder, the pay down of these obligations is a headwind to free cash flows. We are reducing these liabilities in a high interest rate environment, which will help contain our cash interest costs. Therefore, I'm really pleased that we're doing this while still exceeding our initial free cash flow targets for the year. In addition, lowering our financing obligations should enable a more ratable quarterly cadence of our free cash flow in 2024. As we think about our debt mature towers for the next few years, we feel we are in a solid position and expect to address near-term maturities as they come due with cash on hand.

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We had more than $9 billion of cash equivalents and interest-bearing deposits on hand at the end of the quarter. In this high rate environment, we find ourselves in the enviable position of being able to earn more on this cash than the cost of our long-term debt. It is also important to remember that more than 95% of our long-term debt is fixed at an average rate of 4.2%, and a weighted average maturity of 16 years. The financial structure I've outlined improves our financial flexibility and ensures we remain in an advantageous position with respect to our cost of capital. Our expectations for growing free cash flow and reducing our debt as it comes due only further improve that position.

To close, I'd just like to emphasize I could not be happier with what our team has achieved this year. We are very pleased with our operating results as our business fundamentals are largely exceeding our expectations. As John mentioned, we articulate the plan in which we expected to grow customers in a profitable manner, and we're on track to deliver just that.

That concludes my remarks this morning. Let me hand it over to Amir to open it up for Q&A. Amir?

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

Thank you very much, Pascal. Operator, we'll take the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question will come from the line of Brett Feldman of Goldman Sachs.

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

Two, if you don't mind. The first one is, I was hoping we could get your early insights on what drives the uptake of Internet Air, the demo where it's resonating. And I'm also curious how you are deciding which of your in-region markets where it makes sense to launch that product, and maybe whether you're starting to reconsider whether there's opportunities to identify the same conditions out of region? And then just a question for Pascal. I'm curious why you did not increase your adjusted EPS guidance for the year in conjunction with your EBITDA guidance?

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

Nothing's changed in our approach to Internet Air. I think I'd start with the second part of your question, and I'm going to articulate exactly how we see the product being used within our business moving forward. So we don't necessarily distinguish that there's application of the product out of region just as there is in region, although they're a little bit different. I said before I have no issue selling Internet Air into the business segment. It's a really attractive thing for us to do. It's a really helpful product on a number of different fronts. It meets a particular need.

I've shared with you that given what businesses pay for broadband and the other incremental services you can layer on top of them that allows them to have a higher take or a higher ARPU. And their usage characteristics that makes the profitability of serving the product in that segment different than it is in, say, a consumer household with four people that's streaming video all day long. And so we will continue to find opportunities to do that. We have some markets out of region where we're underpenetrated. We have a lot of network valve capacity that we can use. We'll selectively look at opportunities to do that where it makes sense to do that.

I wouldn't tell you that's the dominant driver in region and where we've been putting a lot of time and energy. We start with our customers first. We have a lot of longstanding loyal customers that have been with us. They've been buying bundled services from us, and we can give them a

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better service on Internet Air than we could possibly on the existing infrastructure that's in place, that is generally going to be infrastructure that we're going to be replacing in fairly short order with fiber.

And so as a holding strategy, we may apply the product, in that case, to hold that customer with a better service experience because they're a high-value customer. It allows us to move into our process of shutting down infrastructure in places where we need to ultimately pull out costs, and shut our network and infrastructure, and it becomes a tool in allowing us to do that. And so that's how we intend to use it. And we'll use it, as I said, on a very careful, surgical and target basis. But it really hasn't changed our point of view on the product in aggregate. And Pascal can touch on the EPS issue, which I think is a pretty simple explanation.

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

Brett, here's what I would say. First and foremost, don't read too much into this. We couldn't be happier with the performance of the overall company. And remember, when we gave EPS guidance, we gave a pretty broad range, a $0.10 range. I think it's fair to say we are tracking towards the upper end of that range. But there's more variability in things like capitalized interest, noncash pensions. So it's really just a question on our part but all in all, we feel really good about the overall performance of the business.

Operator

Our next question will come from the line of Simon Flannery of Morgan Stanley.

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

Great. I wonder if we could dig into the fiber and the broadband growth. That 9% ARPU growth is very impressive. Can you just aggregate that a little bit more and then help us understand what's the kind of the take-up of these higher-end tiers and how much further can this growth continue? And then perhaps talk a little bit about DIRECTV and how you see that evolving over time. And how are you thinking about your various strategic options around that?

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

Simon, I don't know if I'll be able to give you the exact number you want. But what I will tell you is the ARPU growth is being driven largely by migration into higher speed plans where customers are moving up in the continuum. Plus, we've been managing the base of some of our embedded stuff at the low end with some pricing adjustments that we've made that's helped. So the spread from bottom to top of the customer base is a little tighter spread than it used to be, in aggregate. But by and large, we've got customers that are choosing to migrate up on speed. And I would tell you, there's a long way for that to run because, as you know as we're deploying today, you had a minimum on the new build, we're putting on 5-gig networks.

And so we've got a lot of customers that have a lot of room to go from maybe their migration into a 1-gig product and ultimately moving up to a 2.5- or 5-gig product as their needs adjust and when they decide they want to do that. So I would also tell you when you look at where we're selling on average price per bit relative to others in the industry, we tend to sell at a bit of a discount, which we're okay with right now. I've outlined before why we think that's a pretty decent strategy at this juncture and allows us to get the faster penetration the way we want to do it. And I think it's also going to help as we move into some bundling strategies moving forward that we -- it gives us a lot of opportunity and flexibility as to how we think about putting those products together without taking any margin erosion in the approach.

So I feel really good that we've got a lot of headroom. I think I would also point out that on the expense side of the equation, we are still scaling. You see it happening each quarter. We're getting better, but in a lot of these metropolitan areas that we're building, we're not quite at optimal scale yet. That's where our build is focused and we move forward, which is to fill in and make sure that we get footprints in numbers of homes passed and workforce sizing that is kind of in an optimal structure. And when we do that, we take cost per down as a result of that. We take cost

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per down in our acquisition costs. We take cost per down in our ongoing maintenance cost. So you should also understand that from a margin accretion perspective, it's not just about driving the ARPU up. It's about us also getting more efficient and effective on the cost line of how we operate that business.

On DTV, we're running the business incredibly well. It's generating the cash that our partnership was designed to generate. The team is very focused on what they're doing. The plan for the first 2 years that we've been in is basically not only track to what we expected but has outperformed what we expected. I think the focus in that mature business has been really good. We're very satisfied with the trajectory of how it's operating. We're extremely satisfied with how the management team is executing the plan that we set up. They're very focused on what their mission is over the next couple of years. My point of view is we continue to run the play we set up. Something else came along that made sense, fine, we'd examine it. But right now, our management team is focused on operating the business.

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

Great. Any update on the BEAD process?

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

Other than the wheels of government turn slowly, not really. It's in the process, and we've been working actively. I would say there's a couple of states that are a little bit further ahead than the other states in the country. If you want to call them bellwether, they're bellwether from the sense of that as they're getting ready to file and submit their applications, it's exposing a couple of the areas where clarification needs to occur in the process, about how the regs are to be applied, how the bids are to be evaluated. That process of getting that clarification between the industry, broadly the state and the federal government is underway. And I think that's where the action is right now. That clarification will, hopefully, allow the states that are maybe second, third, fourth in the queue to be a little bit more precise in their applications. And I suspect that once some of these issues are resolved, there'll be a little less back and forth and a little bit more of the road respond to the application and move forward.

As I've said before, I'm not optimistic that there's customers that are paying monies on BEAD-supported infrastructure builds that impact the 2024 financial plan. I think this is going to be a 2025-plus thing when you kind of look at the aggregate portions of the build, the private capital that comes in and ultimately, customers that come on the network and start buying services that might not have been buying services before.

Operator

Our next question will come from the line of John Hodulik of UBS.

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

Two, if I could. First on wireless. Churn was flat sequentially despite the typical seasonality and continues to come down annually. I mean, just, John, just what are you seeing in the competitive market? Obviously, a lot of concern about what's happening from cable and through other MVNOs. So just trends you're seeing there, and maybe does that suggest that the strength that we typically see in 4Q subs will continue? And then one more, if I may, on the free cash flow. Looking out to '24, not looking for guidance at this point, but anything you can tell us about the piece parts that will drive free cash flow versus these level -- versus the '23 levels next year like CapEx? Or anything you can tell us about working cap, EBITDA or even DIRECTV or tax payments would be great.

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

I'd be happy to have Pascal give a non-answer on guidance for free cash flow next year, but I'm just kidding, John. We'll give you a little texture on it, I guess. On the wireless side, look, I think at the second quarter call last year or last quarter when we talked about where we were on our momentum

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in the market, we articulated what had occurred. We pointed back to specifically one particular account that we had, had some churn in that drove a little bit of an anomaly. We indicated to you that we felt pretty good about our momentum in the market that we expected a normalized third quarter in our performance. And I believe you can look at the tale of tape here and see that there's a normalized third quarter in our performance and nobody else has reported. But from the best of what I can glean in our mechanisms that are out of the market, we're kind of back into a ratable share position. And I think that's actually a preferred position because the way we think about this is I'm actually more interested in growing our share of revenues as opposed to just our share of raw number of customers.

And I think we're doing as good a job of that in the industry as anybody. We're bringing on highly accretive customers, and we continue to see our share of industry revenues improve at a better rate than the share of our actual subscriber counts, which tells me that I think we're focused on those profitable customers and bringing in the right customers. I would tell you the churn numbers, as you indicated, we're very happy with them. They're very strong. They're very solid. So despite what's being reported by MVNOs or cable, our base is incredibly stable.

And you can see what's happening on our road side that's ultimately driving the net numbers. If you step back and think about that in aggregate, if we're growing ARPUs and if we're growing accretive customers, and if our churn is stable, look, I think I'm okay with what's going on. I think that's a good formula. And when I think about where we get ready to approach the fourth quarter, we're kind of right on plan of what we expected just to see happen. We're optimistic about the quarter. We think we're set up well in terms of our staffing levels, our positioning in the market, resources and supplies that we have. We think the product is a relevant product. So no matter what the economic environment is, I don't see anything that's going to necessarily impact the category. I think it's a very popular category for gift giving and what needs to go on. So I would expect we have a strong seasonal fourth quarter like we typically have in the industry, and I don't see that changing right now. Pascal, do you want to give some texture on free cash flow?

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

Sure thing. John, here are the things to keep in mind. We've said this all along. We're trying to build a franchise that is producing sustainable growth in both earnings and cash. We're confident we're going to be able to do that in 2024. So when you think about earnings, here are the piece parts to keep in mind. We continue to expect to grow our Mobility business very nicely as well as continue to drive growth in our fiber broadband business.

Our cost takeout efforts the last couple of years have shown that we are committed to creating a really efficient cost structure. So all those things will help drive EBITDA growth. And you couple that with a step down in CapEx from the elevated levels we've been at in '22 and '23, those are going to be the big growth drivers to drive free cash flow growth next year, offsetting that, we would anticipate DIRECTV contributions to decline along -- consistent with the secular decline of that business. But I would say keep in mind that, that DIRECTV is probably more resilient than many have expected, and the team is doing an incredible job of managing that asset. And then we also expect with the phaseout of the 2017 tax incentives like bonus depreciation, interest limitations, well, we're going to pay more taxes next year. Those are the big piece parts.

Operator

Our next question will come from the line of Phil Cusick of JPMorgan.

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

Maybe under the category of pushing my luck. On CapEx, it's been trending down for the year. The last few years, you've actually had lower CapEx in the fourth quarter, and vendor comments are that things are going to slow more. Should we be looking for a big bounce in the fourth quarter for some reason to get to $24 billion or maybe that is a little high at this point?

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

Yes, Phil, I'd be disappointed if you didn't try to push your luck, but I think we gave you guidance that said our CapEx for the year was going to mirror kind of what we did last year. And I still think that's going to be our guidance that our CapEx for the year is going to mirror what we had last year. So you should expect you're going to see something in the fourth quarter that delivers a number that reflects something very similar in the neighborhood of what we did last year. I've been telling you, I think, for several quarters that our goal is to get to a little bit more ratable construct around how we operate the business, and we've been working hard to do that, meaning we smooth some things out.

We're not quite where we need to be in that regard yet, but we're getting better. So I think you need to be careful leaning extensively on seasonality because if we're doing our job right and we're doing all the right things and managing our working capital and those kinds of things, which I think we're getting progressively better at based on the comments that we gave you earlier, you may see seasonality start to adjust a little bit.

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

If I can, one more. On the fiber side, how are you finding the business doing in terms of shaking customers out of cable, given the low move environment? Are you doing anything different to pull customers away? Or is this just sort of steadily working?

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

We -- what I would say is, I'll maybe reframe your question. We're constantly evolving our tactics and our approach for how we take share. And we're constantly -- I think we're getting better and I -- props to the marketing team that does this and the operating team that does the build. It's really a team effort, frankly, that occurs in these markets. There's no better way to sell the product than having -- digging up somebody's front yard, so to speak. So it builds awareness, and then our job is to capitalize on that awareness and build excitement around it.

And we've done an exceptional job at the front end of making that happen, and we continue to fine-tune our tactics around that. And that's what's led to faster rates of penetration. And it's a huge sensitivity driver and the overall financial performance of the investment, if you can double penetration rates in the first 18 months over what had been historic levels. It's amazing what that does pay back effectively. And we've been really successful at doing that. I think to give you a little color on your question, as we hit the 40% pan level in a market, which we're now getting more and more markets where we're kind of at that 40% share, 40% penetration level, our tactics do switch. And so as more markets hit the 40% level, we have to go to a little bit different set of tactics around how we do that.

And I think, frankly, in many instances, especially where those are in region, they play into our strengths in terms of how we drive more value into the household, how we use the bundling lever in an effective way, how we use data differently to target, what distribution channels we use to contact those customer shift as a result of that. So I would say we have a really fine-tuned set of plays that get us from 0 to 40, and we're pretty good at doing that. And then when we hit 40, we kind of start to use a different set of playbooks in those particular markets as they mature, and I feel really good. The team has their handle on that, and they're doing it the right way. We spend the right money at the right time to unseat those customers, and that's why you see that business scaling so nicely in the way that it is.

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

Since you mentioned it, what is that first 18-month penetration at this point?

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

So next question.

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Operator

Our next question will come from the line of Michael Rollins of Citi.

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

Two, if I could, as well. First, could you discuss the factors behind the slowing wireless device upgrade rate? How it's impacting the financials? And could this go even lower in the future? And then secondly, just an update on where AT&T is on the run rate cost-cutting targets? And if you could size the potential for additional savings over the next 1 to 3 years?

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

Sure, Michael. So I would tell you that I don't think anything has really changed in what we see in the device rate and whether or not it slows dramatically over what its current rate is, hard to say. I would say the bias is pick your view of what the economic environment does, and that's probably the higher correlation as to what happens to the upgrade rate. And if there's a more stressed economic environment, maybe it slows a bit. If it stays healthy and robust and kind of works along where we're at right now, then I don't think it's going to dramatically change.

I think what we've been seeing in general is a couple of things. I've mentioned this before in other calls, and it doesn't change my point of view. The devices, frankly, from generation to generation, change a little bit less. It's harder to get differentiation in the hardware. I mean, they're really good cameras on them, and there's really good modems. And they all have really good speed because of the spectrum bands that handle them. And so customers aren't necessarily hanging on a device evolution to say there's such a dramatic uptick in functionality that I can't use my device for several years.

Two, I think people or the human body, the commercial case industry that is responsible for protecting devices, people are dropping them less, and they're taking better care of them. And as a result of that, they last a little bit longer. You add on to that, the fact that we're very successful at selling insurance into our customer base. Because we sell insurance, customers are more prone to potentially take a replacement device within the terms of the agreement that they have rather than swap out to a new device, and that has worked out well for customers. And it works out well for us, and that tends to extend the life cycle a bit.

And look, as devices get expensive, more expensive and they are getting more expensive for whatever reason, consumers are rational animals. And like any other more expensive thing, oftentimes, you keep it a little bit longer, you try to squeeze a little bit more out of it. And I think there's a cycle of that occurring. So I think that's why we're seeing the cycle we're seeing. Whether it continues to drive its way down or it kind of flattens out remains to be seen, but it's pretty explainable. And I don't think it's going to substantially alter kind of our point of view of [momentum] views for you and what we're looking at as we move forward.

On the run rate on cost cutting that you asked about. Look, the run rate is we did $6 billion over 3 years, right? And we did that in an inflationary environment. So it was really like, I would say, it's 130% of what we really wanted to do when you think about what we were able to actually work through and get done. We've given you $2 billion more over the next 3 years. You saw that we took an accrual this quarter. That accrual is set up through the course of next year. I think if you want to understand how we expect some of these costs to go, there's probably a correlation to that accrual that you should think about. That's obviously not all of it, but it's a portion of it. It would give you some indication of how we think about feathering this in over the course of the next 12 months.

And I would say, as I indicated in my opening remarks, we feel really good about where we are in momentum right now and some of the things we have underway. I mentioned to you many quarters ago that we're -- we've been investing in our information technology infrastructure. It's been painful. It requires a lot of work. It's very, very detailed work every time you change out a CRM system or a billing system. And you have to carefully deal with your customer base and your different distribution channels. We're now getting to the point where we're starting to turn some scale up on those platforms. That, coupled with the fact that more of our activity is built on fiber and wireless, is giving us a different kind of cost structure in the business.

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We're going to continue to ride that curve. We're going to continue to make sure that we streamline the business effectively for what we have as the new products moving forward. That's part of the legacy migration of what we've been doing in geographic footprint shutdown. And I feel really good about us being able to achieve that $2 billion over the next 3 years.

Operator

And our next question will come from the line of Craig Moffett of MoffettNathanson.

Craig Eder Moffett - *MoffettNathanson LLC - Co-Founder, Founding Partner & Senior Research Analyst*

I want to stay with the topic you were just discussing about upgrade rates and things and just try to get a sense of what you're seeing in terms of the new iPhone launch and what that might mean for margins in the fourth quarter. And then just a second question, if I could, just to clarify your remarks earlier on the BEAD program. As it does ramp up in what now sounds more likely to be 2025, would you expect that, that would be, to some degree, a substitute for some of your fiber builds that are currently thought of as competitive overbuilds? Or would they be a supplement to competitive overbuilds?

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

So I -- what I would tell you, Craig, is I've made some comments in my opening remarks that we had a preorder rate in this cycle that was probably the best that we've seen in a long period of time. And whether or not that's unique to AT&T or unique to the industry, I don't know. I have not heard others report at this juncture. I don't know what their guidance is going to be, but I will tell you that our upgrade rate was a bit higher than what we have seen in the last several quarters. But it wasn't what I would call out of pattern, where it's going to be anything that is inconsistent with the guidance we've given you on our margins for the year and inconsistent with what we expect for the business performing. So everything that we have articulated to you where we would guide in on service revenue growth, what we think the operating margins are going to be within the business, our EBITDA performance is all still very much in check relative to what we see going on there.

What I would say on BEAD is I think it will depend. I think in some cases, there could be some instances where there's a substitute in a state, but I think in some cases, there can be some incremental. And a lot of it will depend on the nature of the particular build, geographically where it's located and what our relative contribution is in. And so I would -- I hate to give you such a soft answer, but the good news is it doesn't change anything we've guided you toward in '24. It doesn't change anything we're building now for '24. It doesn't change what we've committed to you for in '25 in terms of our commitment for the total number of fiber homes passed. If we find some incremental opportunities to go after and if we win some, we won't know that until next year. We'll, of course, make some changes but that's not going to be something that you're going to be seeing over the 18-month horizon in terms of what it does to our investment levels, sub count levels or anything like that.

Operator

Our next question will come from the line of David Barden of Bank of America.

David William Barden - *BofA Securities, Research Division - MD & Global Research US Telecom Services & Communications Infrastructure Senior Analyst*

John, a big part of the growth that AT&T and the sector has enjoyed has come from the pricing lever, and you guys were early in calling out pricing is something that had to move to reflect inflation in the economy. But as you look ahead into 2024, given the realities of the cable industry's presence here now and maybe the gravity that they represent from a pricing perspective, could you kind of opine a little bit on how you see the price lever being a part of the kind of short- to medium-term growth story for AT&T? And then maybe also second question, if I could, would be kind of any -- obviously, we just saw the new FCC net neutrality NRPM come out. I'm wondering if there's anything new in there that you see that you incrementally agree or disagree with based on what we kind of went through with Wheeler on this topic?

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

Really just trying to fire me up, aren't you?

David William Barden - *BofA Securities, Research Division - MD & Global Research US Telecom Services & Communications Infrastructure Senior Analyst*

Got to get you going in the morning, John.

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

I guess. Here's how I kind of view the pricing issue. First of all, the industry has invested in an incredible level. If you kind of look, last year was a record investment level for the wireless industry. It's entirely possible. Obviously, don't know yet, but I look at trends that are going on. It's entirely possible this year could be pretty close to that as well. And so it's not a surprise to me in a rational industry when investment levels are up like that, that there's a desire to make sure that everybody is getting a return on these massive investments they're making, and the incredible performance that they're putting out on these networks and the value that's driving into the consumer experience.

And so I step back from that and say, is it perfectly reasonable with what I see going on with the industry in general and other players in the market. Understanding that, that value equation as customers are getting more speed, more reliability, greater capability that, that value exchange needs to be adjusted a little bit. And I see that happening. And I see it happening in a lot of different quarters in a lot of different ways. And sometimes, it manifests itself in an exchange for value giving -- because there's more capacity out there giving people more free things, more hotspots for an incremental amount of money. Sometimes it's looking at those that are maybe at the ratio of how much they're using to how much they're paying need to be hit a little bit as a result of it.

But I see a lot of rational moves in that regard. And I think as the market continues to mature, the industry, from my point of view, has shown that it can do that in a fairly effective way. And I look at things like customer satisfaction and utility and use, and all those things are headed in the right direction. So I'm going to conclude that it's being done in a fairly smart way. And I look at -- I know my numbers, and I look at my churn numbers, and my churn numbers are really, really good. We're really pleased in that regard.

And so to me, it's like there is plenty of places navigate and look at this and do it strategically if you're experienced in managing a subscription base, which I think that we are and I think we've done over time. Cable is running the play that they're running. They're attacking a particular segment of the market that they want to attack. I'm a person that kind of use things long term and structurally. And as I've said before, I don't think it's a sustainable strategy to be the low cost or price leader in a market when you're on a variable cost structure. And so ultimately, there's some repricing. It's a little bit lumpy at times in this industry. We know that, that's the case. But ultimately, there's a repricing that goes on.

And our job is play for the long haul, and that's why we're focused on accretive, profitable growth, looking for the right customers, the ones that want to stay with us. And I think we're doing just fine in that regard. And if you get those customers that really understand the value that you bring to the equation, you shouldn't have a problem adjusting pricing on that value as you work through the evolution of your product.

So on to your second question. The United States demonstrated coming through the pandemic that it had one of the best and most scalable broadband infrastructures in the world, both at home and at business. And where other regions of the world were doing silly and crazy things, we relocated massive amounts of work and shifted massive amounts of traffic on wireless networks from the urban core during the days to the suburban residential dwellings. And we shifted video from workplaces to home, and we performed remarkably well.

And that's indicative, I think, of what has been very sound and good policy driving investment in infrastructure in this country. We're, as I just said, coming off a record investment year in wireless infrastructure. If you look at fiber, there is -- I've never seen the amount of private capital and money that's going into fiber builds right now around the United States that are incenting more infrastructure builds on that side. We just passed the

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Bipartisan Infrastructure Act, and the Bipartisan Infrastructure Act not only dealt with the underserved, but it had a component in there for affordability of the underserved.

And I think what's most important to understand is while the government is putting up $43 billion, $44 billion for that, private capital will probably match that to the tune of about $100 billion. You could have $150 billion of investment going in to solve the underserved and unconnected problem. There's more choice every day in the broadband industry. There's no indications that in the ISP segment, there's any discrimination going on. We have an industry in aggregate that supports no blocking, no paid prioritization, no throttling contrary to what we see going on with some platform apps that are out there, that are choosing to do some of those things in how they operate their business.

The ISP industry is, I think, the last of customers concerned, no customers are complaining about what's going on in that front. So why we would use taxpayer money and resources and political capital to chase a problem that doesn't exist is a bit of a mystery to me? Chasing an unnecessary partisan issue when we have bipartisan issues, potential bipartisan issues like what is the competitive spectrum policy for the United States, and how do we reauthorize spectrum authority so that we can keep pace with places like China and have a growing economic environment and great innovation. How do we deal with the fact we have a broken universal service process that is so important for those that can't afford their services to make sure that it's sustainable?

These are bipartisan issue that need to be dealt with and solved. I think that's where regulators should be spending their time. Now having said that, I think the facts are pretty clear. We will participate in the process with the FCC constructively. We're going to bring all this data to bear. We're going to demonstrate that this is, in fact, how the markets are operating. Hopefully, there's reasonable individuals that take that, get a good reading of it, understand it and decide to set policy consistent with that, that, that reality ultimately results in rational policy, and we see a reasonable outcome on that.

And I haven't given up hope that, that could be the case. However, if what we end up is a heavy-handed approach of taking early 1900s regulation and applying it against the Internet and using it as a government influence to something that's working just fine in the public markets, I will tell you, as a company, we will do everything we need to do to ensure that the record reflects what the law allows the regulator to do and what the record supports. So that's kind of where I add on it at this juncture.

Operator

Our last question will come from the line of Frank Louthan of Raymond James.

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

On the business side, can you characterize the decline year-over-year in terms of whether -- how much of that is weighted to slower or sort of weaker business environment versus exiting unprofitable or low margin products? And then secondly, on the international roaming contribution, where are we on that relative to sort of pre-pandemic levels as far as its contribution to wireless ARPU? And when does that comp start to get a little harder?

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

Frank, business side, here's how I would kind of rank the overall impact. One, the most significant impact that is occurring in the fixed wireline business is what I will call the secular change of technology. So it's the managed complex networking shift toward SDN, which means provision raw bandwidth and use software. And there's an effectiveness and efficiency issue that comes on with that. You shift -- you may keep a customer, you continue to do business with a customer, but you don't shift that technology dollar for dollar. That's probably our most significant.

The second part is our decision to exit certain product sets that are low margin and are inconsistent with our ability to sell that core transport in that secular shifting environment. Whereas before, when we were engineering and provisioning highly complex and managed networks, we

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oftentimes had to bundle and bring things together, which -- to win the business, which oftentimes led us to distribute and layer on top of that other products and services, in this more of a streamlined focused approach on transport and the accretive aspects of transport.

The second dynamic that's occurring is us backing away from kind of layering on the resale of some of those services. I would tell you that the dynamic around business demand is relatively small, if nonexistent dynamic, in what's happening overall in our revenues. I think there's still a healthy demand in business. And I would point out that while we report on fixed business segment specifically, when you look at our aggregate business performance, it's a very different story.

So if you were to kind of take our wireless business component and add it to the fixed business, you have a relatively flat dynamic that's going on, and that's largely because of the growth in wireless. And I actually think we're on the front end right now of many businesses now understanding the wireless technology is their next strategic frontier of how they engineer their processes and their company. And I'm actually pretty bullish that what we saw in the early days of VPN where managed networks and managed capabilities and supported capabilities on complex networks were a big growth cycle in enterprise customers. I think we're going to see the same thing start to emerge on the wireless side. And I think that's just going to be growth. And when we have the presence we do in these large customers, the fact that we're calling on them with one set of services and we can sell both sets of services is really important for us, despite some of the secular headwinds we're taking and the technology shift out on the fixed side.

Okay. Amir, I'm going to take the liberty of maybe closing this if I can since you said last question. I'd like to thank, first of all, all of you for joining us today. And I would tell you, the way I feel about this quarter is that the pieces have largely fallen into place for us. We have the right formula across the board and the company that's delivering the type of value that we wanted to engineer this business to deliver. And I think, in fact, if you look at the numbers and what we reported, it is delivering. And I think what you are seeing is the results of consistency. Consistency of how we're executing in the business, our go-to-market approach and the focus, the focus on a select number of products and lines of business that is making the difference of how effectively we're operating the company.

And I'm really proud of what the team has done to get us to this point. It's not been an easy trail. It's been one that's had a lot of hard decisions. But it's nice to see those hard decisions paying off and the tangible results that drive returns back into the shareholder base.

And I can promise you, we're all focused on closing the year strong and sustaining the momentum that you're seeing in the third quarter. So I thank you very much for your interest in AT&T, and hope you all have a good Halloween.

Operator

Ladies and gentlemen, that does conclude our conference call for today. We'd like to thank you for participating in today's earnings conference call. Thank you for using our service. Have a wonderful day. You may now disconnect.

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