AT&T INC.
Form 10-Q
August 03, 2012

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2012

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 1-8610

AT&T INC.

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

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

	[X]	Accelerated filer	[ ]

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]

At July 31, 2012 there were 5,769 million common shares outstanding.

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

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

	Three months ended June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Operating Revenues				
Wireless service	$ 14,765	$ 14,157	$ 29,331	$ 28,118
Data	7,923	7,349	15,718	14,520
Voice	5,697	6,340	11,590	12,890
Directory	305	841	1,049	1,709
Other	2,885	2,808	5,709	5,505
Total operating revenues	31,575	31,495	63,397	62,742
Operating Expenses				
Cost of services and sales (exclusive of depreciation and amortization shown separately below)	12,369	12,756	25,282	25,569
Selling, general and administrative	7,890	7,972	16,138	16,014
Depreciation and amortization	4,499	4,602	9,059	9,186
Total operating expenses	24,758	25,330	50,479	50,769
Operating Income	6,817	6,165	12,918	11,973
Other Income (Expense)				
Interest expense	(941)	(848)	(1,800)	(1,694)
Equity in net income of affiliates	132	207	355	456
Other income (expense) – net	23	27	75	86
Total other income (expense)	(786)	(614)	(1,370)	(1,152)
Income Before Income Taxes	6,031	5,551	11,548	10,821
Income tax expense	2,066	1,893	3,931	3,695
Net Income	3,965	3,658	7,617	7,126
Less: Net Income Attributable to Noncontrolling Interest	(63)	(67)	(131)	(127)
Net Income Attributable to AT&T	$ 3,902	$ 3,591	$ 7,486	$ 6,999
Basic Earnings Per Share Attributable to AT&T	$ 0.67	$ 0.60	$ 1.27	$ 1.18
Diluted Earnings Per Share Attributable to AT&T	$ 0.66	$ 0.60	$ 1.27	$ 1.18
Weighted Average Number of Common Shares Outstanding – Basic (in millions)	5,855	5,932	5,886	5,929
Weighted Average Number of Common Shares Outstanding – with Dilution (in millions)	5,876	5,953	5,907	5,948
Dividends Declared Per Common Share	$ 0.44	$ 0.43	$ 0.88	$ 0.86

See Notes to Consolidated Financial Statements.

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AT&T INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Dollars in millions
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net income	$3,965	$3,658	$7,617	$7,126
Other comprehensive income, net of tax:				
Foreign currency translation adjustments (includes $(1), $0, $0 and $0 attributable to noncontrolling interest), net of taxes of $(55), $73, $76 and $123	(101)	135	142	228
Net unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses), net of taxes of $(27), $2, $27 and $29	(52)	6	49	55
Reclassification adjustment realized in net income, net of taxes of $(3), $(2), $(6) and $(21)	(6)	(6)	(12)	(41)
Net unrealized gains (losses) on cash flow hedges:				
Unrealized losses, net of taxes of $(58), $(12), $(58) and $(8)	(107)	(21)	(107)	(14)
Reclassification adjustment included in net income, net of taxes of $4, $2, $7 and $3	7	3	13	5
Defined benefit postretirement plans:				
Net actuarial loss from equity method investees arising during period, net of taxes of $(29), $0, $(29) and $0	(53)	-	(53)	-
Amortization of net prior service credit included in net income, net of taxes of $(87), $(66), $(171) and $(137)	(137)	(109)	(274)	(224)
Other	1	(1)	1	(1)
Other comprehensive income (loss)	(448)	7	(241)	8
Total comprehensive income	3,517	3,665	7,376	7,134
Less: Total comprehensive income attributable to noncontrolling interest	(62)	(67)	(131)	(127)
Total Comprehensive Income Attributable to AT&T	$3,455	$3,598	$7,245	$7,007

See Notes to Consolidated Financial Statements.

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

	June 30, 2012 (Unaudited)	December 31, 2011
Assets		
Current Assets		
Cash and cash equivalents	$2,151	$3,185
Accounts receivable - net of allowances for doubtful accounts of $614 and $878	12,430	13,606
Prepaid expenses	1,533	1,155
Deferred income taxes	1,418	1,470
Other current assets	1,624	3,611
Total current assets	19,156	23,027
Property, plant and equipment	263,648	260,279
Less: accumulated depreciation and amortization	(156,165)	(153,192)
Property, Plant and Equipment – Net	107,483	107,087
Goodwill	69,763	70,842
Licenses	51,981	51,374
Customer Lists and Relationships – Net	1,881	2,757
Other Intangible Assets – Net	5,045	5,212
Investments in and Advances to Equity Affiliates	4,388	3,718
Other Assets	6,597	6,327
Total Assets	$266,294	$270,344
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	$3,402	$3,453
Accounts payable and accrued liabilities	16,298	19,858
Advanced billing and customer deposits	3,743	3,872
Accrued taxes	3,705	1,003
Dividends payable	2,554	2,608
Total current liabilities	29,702	30,794
Long-Term Debt	61,132	61,300
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	26,011	25,748
Postemployment benefit obligation	34,021	34,011
Other noncurrent liabilities	11,849	12,694
Total deferred credits and other noncurrent liabilities	71,881	72,453
Stockholders' Equity		
Common stock ($1 par value, 14,000,000,000 authorized at June 30, 2012 and December 31, 2011: issued 6,495,231,088 at June 30, 2012 and December 31, 2011	6,495	6,495
Additional paid-in capital	90,927	91,156
Retained earnings	27,788	25,453
Treasury stock (690,487,327 at June 30, 2012 and 568,719,202 at December 31, 2011, at cost)	(24,869)	(20,750)
Accumulated other comprehensive income	2,939	3,180
Noncontrolling interest	299	263

Total stockholders' equity	103,579	105,797
Total Liabilities and Stockholders' Equity	$266,294	$270,344

See Notes to Consolidated Financial Statements.

AT&T INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Dollars in millions
(Unaudited)

	Six months ended June 30, 2012	Six months ended June 30, 2011
Operating Activities		
Net income	$7,617	$7,126
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,059	9,186
Undistributed earnings from investments in equity affiliates	(355)	(417)
Provision for uncollectible accounts	572	523
Deferred income tax (benefit) expense and noncurrent unrecognized tax benefits	(639)	2,818
Net loss (gain) from sale of investments, net of impairments	2	(44)
Changes in operating assets and liabilities:		
Accounts receivable	(220)	(521)
Other current assets	1,228	1,007
Accounts payable and accrued liabilities	441	(2,037)
Other - net	(246)	(884)
Total adjustments	9,842	9,631
Net Cash Provided by Operating Activities	17,459	16,757
Investing Activities		
Construction and capital expenditures:		
Capital expenditures	(8,742)	(9,405)
Interest during construction	(130)	(77)
Acquisitions, net of cash acquired	(477)	(62)
Dispositions	800	30
(Purchases) and sales of securities, net	124	45
Other	-	19
Net Cash Used in Investing Activities	(8,425)	(9,450)
Financing Activities		
Net change in short-term borrowings with original maturities of three months or less	-	(1,603)
Issuance of long-term debt	6,935	2,985
Repayment of long-term debt	(7,035)	(1,290)
Purchase of treasury stock	(4,623)	-
Issuance of treasury stock	376	199
Dividends paid	(5,187)	(5,082)
Other	(534)	(122)
Net Cash Used in Financing Activities	(10,068)	(4,913)
Net (decrease) increase in cash and cash equivalents	(1,034)	2,394
Cash and cash equivalents beginning of year	3,185	1,437
Cash and Cash Equivalents End of Period	$2,151	$3,831
Cash paid during the six months ended June 30 for:		
Interest	$2,373	$2,200
Income taxes, net of refunds	$127	$(196)

See Notes to Consolidated Financial Statements.

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AT&T INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
Dollars and shares in millions except per share amounts
(Unaudited)

	June 30, 2012	
	Shares	Amount
Common Stock		
Balance at beginning of year	6,495	$ 6,495
Issuance of stock	-	-
Balance at end of period	6,495	$ 6,495
Additional Paid-In Capital		
Balance at beginning of year		$ 91,156
Issuance of treasury stock		109
Share-based payments		(178)
Share of equity method investee capital transactions		(160)
Balance at end of period		$ 90,927
Retained Earnings		
Balance at beginning of year		$ 25,453
Net income attributable to AT&T ($1.27 per diluted share)		7,486
Dividends to stockholders ($0.88 per share)		(5,137)
Other		(14)
Balance at end of period		$ 27,788
Treasury Stock		
Balance at beginning of year	(568)	$ (20,750)
Purchase of stock	(143)	(4,623)
Issuance of treasury stock	21	504
Balance at end of period	(690)	$ (24,869)
Accumulated Other Comprehensive Income Attributable to AT&T, net of tax		
Balance at beginning of year		$ 3,180
Other comprehensive loss attributable to AT&T		(241)
Balance at end of period		$ 2,939
Noncontrolling Interest		
Balance at beginning of year		$ 263
Net income attributable to noncontrolling interest		131
Distributions		(95)
Balance at end of period		$ 299
Total Stockholders' Equity at beginning of year		$ 105,797
Total Stockholders' Equity at end of period		$ 103,579

See Notes to Consolidated Financial Statements.

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AT&T INC.
JUNE 30, 2012

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

NOTE 1. PREPARATION OF INTERIM FINANCIAL STATEMENTS

Basis of Presentation Throughout this document, AT&T Inc. is referred to as “AT&T,” “we” or the “Company.” We believe that these consolidated financial statements include all adjustments (consisting only of normal recurring accruals) necessary to present fairly the results for the presented interim periods. The results for the interim periods are not necessarily indicative of those for the full year. You should read this document in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2011.

The consolidated financial statements include the accounts of the Company and our majority-owned subsidiaries and affiliates. Our subsidiaries and affiliates operate in the communications services industry both in the United States and internationally, providing wireless communications services, local exchange services, long-distance services, data/broadband and Internet services, video services, telecommunications equipment, managed networking and wholesale services. On May 8, 2012, we completed the sale of our Advertising Solutions segment to an affiliate of Cerberus Capital Management, L.P. for $750 in cash, a $200 note and a 47% equity interest in the new entity, YP Holdings LLC (YP Holdings), subject to closing adjustments. Our operating results include the results of the Advertising Solutions segment through May 8. Beginning on May 9, we included our 47% equity in YP Holdings in equity in net income of affiliates in our Other segment and on our consolidated income statement.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Earnings from certain foreign equity investments accounted for using the equity method are included for periods ended within up to one month of our period end. We also record our proportionate share of our equity method investees’ other comprehensive income items, including actuarial gains and losses on pension and other postretirement benefit obligations.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimates of probable losses and expenses. Actual results could differ from those estimates. We have reclassified certain amounts in prior-period financial statements to conform to the current period’s presentation, including a reclassification of certain operating expenses based on an enhanced activity-based expense tracking system.

Employee Separations We established obligations for expected termination benefits provided under existing plans to former or inactive employees after employment but before retirement. At June 30, 2012, we had severance accruals of $129 and at December 31, 2011, we had severance accruals of $335.

Stock Repurchase Program In December 2010, the Board of Directors authorized the repurchase of up to 300 million shares of AT&T common stock. We began buying back stock under this program in January 2012. For the six months ended June 30, 2012, we had repurchased approximately 143 million shares totaling $4,623. In July 2012, the Board of Directors authorized the repurchase of an additional 300 million shares. We intend to continue repurchasing shares.

To implement these authorizations, we use open market repurchase programs, relying on Rule 10b5-1 where feasible. We also use accelerated share repurchase programs with large financial institutions since these programs allow us to more efficiently repurchase our stock.

AT&T INC.
JUNE 30, 2012

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

NOTE 2. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for net income attributable to AT&T for the three and six months ended June 30, 2012 and 2011, are shown in the table below:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Numerators				
Numerator for basic earnings per share:				
Net Income	$3,965	$3,658	$7,617	$7,126
Net income attributable to noncontrolling interest	(63)	(67)	(131)	(127)
Net Income attributable to AT&T	3,902	3,591	7,486	6,999
Dilutive potential common shares:				
Other share-based payment	2	3	6	6
Numerator for diluted earnings per share	$3,904	$3,594	$7,492	$7,005
Denominators (000,000)				
Denominator for basic earnings per share:				
Weighted average number of common shares outstanding	5,855	5,932	5,886	5,929
Dilutive potential common shares:				
Stock options	4	5	4	4
Other share-based payment	17	16	17	15
Denominator for diluted earnings per share	5,876	5,953	5,907	5,948
Basic earnings per share attributable to AT&T	$0.67	$0.60	$1.27	$1.18
Diluted earnings per share attributable to AT&T	$0.66	$0.60	$1.27	$1.18

At June 30, 2012 and 2011, we had issued and outstanding options to purchase approximately 22 million and 90 million shares of AT&T common stock. For the quarter ended June 30, 2012 and 2011, the exercise prices of 4 million and 57 million shares were above the market price of AT&T stock for the respective periods. Accordingly, we did not include these amounts in determining the dilutive potential common shares. At June 30, 2012 and 2011, the exercise prices of 17 million and 30 million vested stock options were below market price.

AT&T INC.
JUNE 30, 2012

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

NOTE 3. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services over various technology platforms and are managed accordingly. We analyze our various operating segments based on segment income before income taxes. We make our capital allocations decisions based on our strategic direction of the business, needs of the network (wireless or wireline) providing services and other assets needed to provide emerging services to our customers. Actuarial gains and losses from pension and other postretirement benefits, interest expense and other income (expense) – net, are managed only on a total company basis and are, accordingly, reflected only in consolidated results. The customers and long-lived assets of our reportable segments are predominantly in the United States. We have four reportable segments: (1) Wireless, (2) Wireline, (3) Advertising Solutions and (4) Other.

The Wireless segment uses our nationwide network to provide consumer and business customers with wireless voice and advanced data communications services. The Wireless segment results have been reclassified to include the operating results of a subsidiary that provides services for subscribers to wirelessly monitor their home that was previously reported in the Wireline segment.

The Wireline segment uses our regional, national and global network to provide consumer and business customers with landline voice and data communications services, AT&T U-verse® TV, high-speed broadband and voice services and managed networking to business customers. Additionally, we receive commissions on sales of satellite television services offered through our agency arrangements. The Wireline segment results have been reclassified to exclude the operating results of the business moved to our Wireless segment and to include the operating results of customer information services, which were previously reported in our Other segment's results.

The Advertising Solutions segment includes our directory operations, which publish Yellow and White Pages directories and sell directory advertising and Internet-based advertising and local search through May 8, 2012 (see Note 1).

The Other segment includes our portion of the results from our international equity investments, our 47 percent equity interest in YP Holdings and all corporate and other operations. Also included in the Other segment are impacts of corporate-wide decisions for which the individual operating segments are not being evaluated, including interest cost and expected return on plan assets for our pension and postretirement benefit plans. The Other segment results have been reclassified to exclude the operating results of customer information services, which are now reported in our Wireline segment's results.

In the following tables, we show how our segment results are reconciled to our consolidated results reported.

AT&T INC.
JUNE 30, 2012

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

For the three months ended June 30, 2012

	Wireless	Wireline	Advertising Solutions	Other	Consolidations	Consolidated Results
Total segment operating revenue	$ 16,353	$ 14,904	$ 305	$ 13	$ -	$ 31,575
Operations and support expenses	9,705	10,085	226	243	-	20,259
Depreciation and amortization expense	1,696	2,766	29	8	-	4,499
Total segment operating expense	11,401	12,851	255	251	-	24,758
Segment operating income (loss)	4,952	2,053	50	(238)	-	6,817
Interest expense	-	-	-	-	941	941
Equity in net income (loss) of affiliates	(15)	(1)	-	148	-	132
Other income (expense) - net	-	-	-	-	23	23
Segment income (loss) before income taxes	$ 4,937	$ 2,052	$ 50	$ (90)	$ (918)	$ 6,031

For the six months ended June 30, 2012

	Wireless	Wireline	Advertising Solutions	Other	Consolidations	Consolidated Results
Total segment operating revenue	$ 32,489	$ 29,832	$ 1,049	$ 27	$ -	$ 63,397
Operations and support expenses	19,788	20,382	773	477	-	41,420
Depreciation and amortization expense	3,362	5,574	106	17	-	9,059
Total segment operating expense	23,150	25,956	879	494	-	50,479
Segment operating income (loss)	9,339	3,876	170	(467)	-	12,918
Interest expense	-	-	-	-	1,800	1,800
Equity in net income (loss) of affiliates	(28)	(1)	-	384	-	355
Other income (expense) - net	-	-	-	-	75	75
Segment income (loss) before income taxes	$ 9,311	$ 3,875	$ 170	$ (83)	$ (1,725)	$ 11,548

For the three months ended June 30, 2011

	Wireless	Wireline	Advertising Solutions	Other	Consolidations	Consolidated Results
Total segment operating revenue	$ 15,603	$ 15,030	$ 841	$ 21	$ -	$ 31,495
Operations and support expenses	9,786	10,145	581	216	-	20,728
Depreciation and amortization expense	1,615	2,876	101	10	-	4,602
Total segment operating expense	11,401	13,021	682	226	-	25,330
Segment operating income (loss)	4,202	2,009	159	(205)	-	6,165
Interest expense	-	-	-	-	848	848
Equity in net income (loss) of affiliates	(7)	-	-	214	-	207
Other income (expense) - net	-	-	-	-	27	27
Segment income (loss) before income taxes	$ 4,195	$ 2,009	$ 159	$ 9	$ (821)	$ 5,551

For the six months ended June 30, 2011

	Wireless	Wireline	Advertising Solutions	Other	Consolidations	Consolidated Results
Total segment operating revenue	$ 30,913	$ 30,081	$ 1,709	$ 39	$ -	$ 62,742
Operations and support expenses	19,647	20,457	1,153	326	-	41,583
Depreciation and amortization expense	3,121	5,834	207	24	-	9,186
Total segment operating expense	22,768	26,291	1,360	350	-	50,769
Segment operating income (loss)	8,145	3,790	349	(311)	-	11,973
Interest expense	-	-	-	-	1,694	1,694
Equity in net income (loss) of affiliates	(11)	-	-	467	-	456
Other income (expense) - net	-	-	-	-	86	86
Segment income (loss) before income taxes	$ 8,134	$ 3,790	$ 349	$ 156	$ (1,608)	$ 10,821

AT&T INC.
JUNE 30, 2012

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

NOTE 4. PENSION AND POSTRETIREMENT BENEFITS

Substantially all of our employees are covered by one of various noncontributory pension and death benefit plans. We also provide certain medical, dental and life insurance benefits to certain retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits. Our objective in funding these plans, in combination with the standards of the Employee Retirement Income Security Act of 1974, as amended (ERISA), is to accumulate assets sufficient to meet the plans' obligations to provide benefits to employees upon their retirement. No significant cash contributions are required under ERISA regulations during 2012.

The following table details pension and postretirement benefit costs included in operating expenses (in cost of services and sales, and selling, general and administrative expenses) in the accompanying consolidated statements of income. We recognize actual gains and losses on pension and postretirement plan assets in our operating results at our annual measurement date of December 31, unless earlier remeasurements are required.

In the following table, gains are denoted with parentheses. A portion of these benefit costs is capitalized as part of the benefit load on internal construction projects, providing a small reduction in the net expense recorded.

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Pension cost:				
Service cost – benefits earned during the period	$304	$296	$614	$593
Interest cost on projected benefit obligation	700	739	1,400	1,479
Expected return on assets	(880)	(922)	(1,760)	(1,844)
Amortization of prior service (credit)	(4)	(4)	(8)	(8)
Net pension cost	$120	$109	$246	$220
Postretirement cost:				
Service cost – benefits earned during the period	$82	$91	$166	$181
Interest cost on accumulated postretirement benefit obligation	447	512	894	1,025
Expected return on assets	(201)	(260)	(401)	(520)
Amortization of prior service (credit)	(215)	(173)	(432)	(347)
Net postretirement cost	$113	$170	$227	$339
Combined net pension and postretirement cost	$233	$279	$473	$559

Our combined net pension and postretirement cost decreased $46 in the second quarter and $86 for the first six months of 2012. The decrease was related to higher amortization of prior service credits due to our plan change that provides prescription drug benefits on a group basis under Medicare Part D, as allowed under federal healthcare law. Also contributing to the decrease was lower interest costs on the projected benefit obligation, largely offset by a lower expected return on plan assets, reflecting the performance of the U.S. securities markets and declining bond rates.

We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. Net supplemental retirement pension benefits cost, which is not included in the table above, was $32 in the second quarter of 2012, of which $29 was interest cost, and $63 for the first six months, of which $58 was interest cost. In 2011, net supplemental retirement pension benefits cost was $36 in the second quarter, of which $32 was interest cost, and $71 for the first six months, of which $63 was interest cost.

AT&T INC.
JUNE 30, 2012

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

NOTE 5. FAIR VALUE MEASUREMENTS AND DISCLOSURE

The Fair Value Measurement and Disclosure framework provides a three-tiered fair value hierarchy that gives highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that we have the ability to access.

Level 2 Inputs to the valuation methodology include:
- Quoted prices for similar assets and liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in inactive markets.
- Inputs other than quoted market prices that are observable for the asset or liability.
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.
- Fair value is often based on developed models in which there are few, if any, external observations.

The fair value measurement level of an asset or liability within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used should maximize the use of observable inputs and minimize the use of unobservable inputs.

The valuation methodologies described above may produce a fair value calculation that may not be indicative of future net realizable value or reflective of future fair values. We believe our valuation methods are appropriate and consistent with other market participants. The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There have been no changes in the methodologies used since December 31, 2011.

Long-Term Debt and Other Financial Instruments
The carrying amounts and estimated fair values of our long-term debt, including current maturities and other financial instruments, are summarized as follows:

	June 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	$ 64,295	$ 75,191	$ 64,514	$ 73,738
Investment securities	2,061	2,061	2,092	2,092

The fair values of our notes and debentures were estimated based on quoted market prices, where available. The carrying value of debt with an original maturity of less than one year approximates market value. The fair value measurements used for notes and debentures are considered Level 2 under the Fair Value Measurement and Disclosure framework.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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Investment Securities
Our investment securities consist of primarily available-for-sale instruments, which include equities, fixed income bonds and other securities. Substantially all the fair values of our available-for-sale securities were estimated based on quoted market prices. Investments in securities not traded on a national securities exchange are valued using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Realized gains and losses on securities are included in "Other income (expense) – net" in the consolidated statements of income using the specific identification method. Unrealized gains and losses, net of tax, on available-for-sale securities are recorded in accumulated other comprehensive income (accumulated OCI). Unrealized losses that are considered other than temporary are recorded in "Other income (expense) – net" with the corresponding reduction to the carrying basis of the investment. Fixed income investments have maturities of $27 less than one year, $89 within one to three years, $68 within three to five years, and $260 for five or more years.

Our short-term investments, other short- and long-term held-to-maturity investments (including money market securities) and customer deposits are recorded at amortized cost, and the respective carrying amounts approximate fair values.

Our investment securities maturing within one year are recorded in "Other current assets," and instruments with maturities of more than one year are recorded in "Other Assets" on the consolidated balance sheets.

Following is the fair value leveling for available-for-sale securities and derivatives as of June 30, 2012 and December 31, 2011:

	June 30, 2012			
	Level 1	Level 2	Level 3	Total
Available-for-Sale Securities				
Domestic equities	$ 1,007	$ -	$ -	$ 1,007
International equities	516	-	-	516
Fixed income bonds	-	444	-	444
Asset Derivatives1				
Interest rate swaps	-	335	-	335
Cross-currency swaps	-	116	-	116
Foreign exchange contracts	-	3	-	3
Liability Derivatives1				
Cross-currency swaps	-	(1,011)	-	(1,011)
Foreign exchange contracts	-	(8)	-	(8)

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Available-for-Sale Securities				
Domestic equities	$ 947	$ -	$ -	$ 947
International equities	495	-	-	495
Fixed income bonds	-	562	-	562
Asset Derivatives1				
Interest rate swaps	-	521	-	521

Cross-currency swaps	-	144	-	144
Foreign exchange contracts	-	2	-	2
Liability Derivatives1				
Cross-currency swaps	-	(820)	-	(820)
Interest rate locks	-	(173)	-	(173)
Foreign exchange contracts	-	(9)	-	(9)

1 Derivatives designated as hedging instruments are reflected as other assets, other liabilities and, for a portion of interest rate swaps, accounts receivable.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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Derivative Financial Instruments
We employ derivatives to manage certain market risks, primarily interest rate risk and foreign currency exchange risk. This includes the use of interest rate swaps, interest rate locks, foreign exchange forward contracts and combined interest rate foreign exchange contracts (cross-currency swaps). We do not use derivatives for trading or speculative purposes. We record derivatives on our consolidated balance sheets at fair value that is derived from observable market data, including yield curves and foreign exchange rates (all of our derivatives are Level 2). Cash flows associated with derivative instruments are presented in the same category on the consolidated statements of cash flows as the item being hedged.

The majority of our derivatives are designated either as a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), or as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge).

Fair Value Hedging We designate our fixed-to-floating interest rate swaps as fair value hedges. The purpose of these swaps is to manage interest rate risk by managing our mix of fixed-rate and floating-rate debt. These swaps involve the receipt of fixed-rate amounts for floating interest rate payments over the life of the swaps without exchange of the underlying principal amount. Accrued and realized gains or losses from interest rate swaps impact interest expense on the consolidated statements of income. Unrealized gains on interest rate swaps are recorded at fair market value as assets, and unrealized losses on interest rate swaps are recorded at fair market value as liabilities. Changes in the fair value of the interest rate swaps offset changes in the fair value of the fixed-rate notes payable they hedge due to changes in the designated benchmark interest rate and are recognized in interest expense. Gains or losses realized upon early termination of our fair value hedges are recognized in interest expense. In the six months ended June 30, 2012 and June 30, 2011, no ineffectiveness was measured.

Cash Flow Hedging Unrealized gains on derivatives designated as cash flow hedges are recorded at fair value as assets, and unrealized losses on derivatives designated as cash flow hedges are recorded at fair value as liabilities, both for the period they are outstanding. For derivative instruments designated as cash flow hedges, the effective portion is reported as a component of accumulated OCI until reclassified into interest expense in the same period the hedged transaction affects earnings. The gain or loss on the ineffective portion is recognized as other income or expense in each period.

We designate our cross-currency swaps as cash flow hedges. We have entered into multiple cross-currency swaps to hedge our exposure to variability in expected future cash flows that are attributable to foreign currency risk generated from the issuance of our Euro and British pound sterling denominated debt. These agreements include initial and final exchanges of principal from fixed foreign denominations to fixed U.S. denominated amounts, to be exchanged at a specified rate, which was determined by the market spot rate upon issuance. They also include an interest rate swap of a fixed foreign-denominated rate to a fixed U.S. denominated interest rate. We evaluate the effectiveness of our cross-currency swaps each quarter. In the six months ended June 30, 2012 and June 30, 2011, no ineffectiveness was measured.

Periodically, we enter into and designate interest rate locks to partially hedge the risk of changes in interest payments attributable to increases in the benchmark interest rate during the period leading up to the probable issuance of fixed-rate debt. We designate our interest rate locks as cash flow hedges. Gains and losses when we settle our interest rate locks are amortized into income over the life of the related debt, except where a material amount is deemed to be ineffective, which would be immediately reclassified to income. Over the next 12 months, we expect to reclassify $45 from accumulated OCI to interest expense due to the amortization of net losses on historical interest rate locks. In February 2012, we utilized $800 notional value of interest rate locks related to our February 2012 debt issuance.

We hedge a large portion of the exchange risk involved in anticipation of highly probable foreign currency-denominated transactions. In anticipation of these transactions, we often enter into foreign exchange contracts to provide currency at a fixed rate. Some of these instruments are designated as cash flow hedges while others remain nondesignated, largely based on size and duration. Gains and losses at the time we settle or take delivery on our designated foreign exchange contracts are amortized into income in the same period the hedged transaction affects earnings, except where an amount is deemed to be ineffective, which would be immediately reclassified to income. In the six months ended June 30, 2012 and June 30, 2011, no ineffectiveness was measured.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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Collateral and Credit-Risk Contingency We have entered into agreements with our derivative counterparties establishing collateral thresholds based on respective credit ratings and netting agreements. At June 30, 2012, we had posted collateral of $308 (a deposit asset) and held collateral of $54 (a receipt liability). Under the agreements, if our credit rating had been downgraded one rating level by Moody's Investors Service and Fitch, Inc. before the final collateral exchange in June, we would have been required to post additional collateral of $163. At December 31, 2011, we had posted collateral of $98 (a deposit asset) and had no held collateral (a receipt liability). We do not offset the fair value of collateral, whether the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable), against the fair value of the derivative instruments.

Following is the notional amount of our outstanding derivative positions:

	June 30, 2012	December 31, 2011
Interest rate swaps	$4,000	$8,800
Cross-currency swaps	9,481	7,502
Interest rate locks	-	800
Foreign exchange contracts	174	207
Total	$13,655	$17,309

Following is the related hedged items affecting our financial position and performance:

Effect of Derivatives on the Consolidated Statements of Income

	Three months ended		Six months ended	
Fair Value Hedging Relationships	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Interest rate swaps (Interest expense):				
Gain (Loss) on interest rate swaps	$(76)	$75	$(137)	$(11)
Gain (Loss) on long-term debt	76	(75)	137	11

In addition, the net swap settlements that accrued and settled in the quarter ended June 30 were also reported as reductions of interest expense.

	Three months ended		Six months ended	
Cash Flow Hedging Relationships	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Cross-currency swaps:				
Gain (Loss) recognized in accumulated OCI	$ (160)	$ (117)	$ (165)	$ (149)
Interest rate locks:				
Gain (Loss) recognized in accumulated OCI	-	87	-	122
Interest income (expense) reclassified from accumulated OCI into income	(11)	(5)	(20)	(8)

Foreign exchange contracts:				
Gain (Loss) recognized in accumulated OCI	(5)	(3)	-	5

The balance of the unrealized derivative gain (loss) in accumulated OCI was $(515) at June 30, 2012 and $(421) at December 31, 2011.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
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RESULTS OF OPERATIONS

For ease of reading, AT&T Inc. is referred to as "we," "AT&T" or the "Company" throughout this document, and the names of the particular subsidiaries and affiliates providing the services generally have been omitted. AT&T is a holding company whose subsidiaries and affiliates operate in the communications services industry in both the United States and internationally, providing wireless communications services, local exchange services, long-distance services, data/broadband and Internet services, video services, telecommunications equipment, managed networking and wholesale services. You should read this discussion in conjunction with the consolidated financial statements, accompanying notes and management's discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the year ended December 31, 2011. A reference to a "Note" in this section refers to the accompanying Notes to Consolidated Financial Statements. In the tables throughout this section, percentage increases and decreases that are not considered meaningful are denoted with a dash.

Consolidated Results Our financial results in the second quarter and for the first six months of 2012 and 2011 are summarized as follows:

	Second Quarter			Six-Month Period		
	2012	2011	Percent Change	2012	2011	Percent Change
Operating Revenues	$ 31,575	$ 31,495	0.3 %	$ 63,397	$ 62,742	1.0 %
Operating expenses						
Cost of services and sales	12,369	12,756	(3.0)	25,282	25,569	(1.1)
Selling, general and administrative	7,890	7,972	(1.0)	16,138	16,014	0.8
Depreciation and amortization	4,499	4,602	(2.2)	9,059	9,186	(1.4)
Total Operating Expenses	24,758	25,330	(2.3)	50,479	50,769	(0.6)
Operating Income	6,817	6,165	10.6	12,918	11,973	7.9
Income Before Income Taxes	6,031	5,551	8.6	11,548	10,821	6.7
Net Income	3,965	3,658	8.4	7,617	7,126	6.9
Net Income Attributable to AT&T	$ 3,902	$ 3,591	8.7 %	$ 7,486	$ 6,999	7.0 %

Overview
Operating income increased $652, or 10.6%, in the second quarter and $945, or 7.9%, for the first six months of 2012. The increase was primarily due to continued growth in wireless service and equipment revenue, driven mostly by subscriber and data revenue growth, along with increased revenues from AT&T U-verse® (U-verse) services and strategic business services. Both operating revenues and expenses for the quarter were affected by the May 2012 sale of our Advertising Solutions segment, as discussed below. Our operating income margin in the second quarter increased from 19.6% in 2011 to 21.6% in 2012 and for the first six months increased from 19.1% in 2011 to 20.4% in 2012.

Operating revenues increased $80, or 0.3%, in the second quarter and $655, or 1.0%, for the first six months of 2012. The increase reflects continued growth in wireless service and equipment revenues, driven by growth in the subscriber base and the increasing percentage of smartphone customers which contribute to higher wireless data revenues. Higher wireline data revenues from U-verse services and strategic business services also contributed to the increase. The increase was mostly offset by the Advertising Solutions segment sale, which decreased revenues by $536 in the second quarter and $660 for the first six months, and continued declines in Wireline voice revenues.

Revenue growth continues to be tempered by declines in our voice revenues. Total switched access lines decreased 12.7% since June 30, 2011. Customers disconnecting access lines switched to wireless, Voice over Internet Protocol (VoIP) and cable offerings for voice and data or terminated service permanently as businesses closed or consumers left residences. While we lose wireline voice revenues, we have the opportunity to increase wireless service or wireline data revenues should the customer choose us as their wireless or VoIP provider. We also continue to expand our VoIP service for customers who have access to our U-verse video service.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Continued
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Cost of services and sales expenses decreased $387, or 3.0%, in the second quarter and $287, or 1.1%, for the first six months of 2012. The decrease primarily reflects the sale of our Advertising Solutions segment, which reduced expenses $192 in the second quarter and $222 for the first six months. Expenses also decreased due to lower wireless equipment costs and other non-employee-related expenses partially offset by increased wireline costs attributable to U-verse subscriber growth, higher USF and reseller fees, and wireless network costs.

Selling, general and administrative expenses decreased $82, or 1.0%, in the second quarter and increased $124, or 0.8%, for the six months of 2012. The sale of our Advertising Solutions segment reduced expenses $162 in the second quarter and $159 for the first six months. Also contributing to the second-quarter decrease were lower sales and advertising costs and the T-Mobile USA, Inc. (T-Mobile) related expenses incurred in 2011, which were partially offset by higher selling and administrative fees. The increase in the first six months was primarily due to higher administrative costs, employee-related expenses and increased commissions paid on smartphone upgrades. The increases were partially offset by decreased sales and advertising costs, the sale of our Advertising Solutions Segment, and prior-year T-Mobile expenses.

Depreciation and amortization expense decreased $103, or 2.2%, in the second quarter and $127, or 1.4%, for the first six months of 2012. The sale of our Advertising Solutions segment reduced expenses $72 in the second quarter and $101 for the first six months. Expenses also decreased due to lower amortization of intangibles for customer lists related to acquisitions, partially offset by increased depreciation associated with ongoing capital spending for network upgrades and expansion.

Interest expense increased $93, or 11.0%, in the second quarter and $106, or 6.3%, for the first six months of 2012. Increased interest expense was due to call premiums paid for the early redemption of debt in the second quarter, which were partially offset by net gains on the settlement of interest-rate swaps and an increase in the amount of interest capitalized on wireless spectrum that will be used in the future.

Equity in net income of affiliates decreased $75, or 36.2%, in the second quarter and $101, or 22.1%, for the first six months of 2012. Decreased equity in net income of affiliates was due to decreased earnings at América Móvil, S.A. de C.V. (América Móvil), resulting from foreign exchange losses. Partially offsetting the decreases were earnings from YP Holdings LLC (YP Holdings).

Other income (expense) – net We had other income of $23 in the second quarter and $75 for the first six months of 2012, compared to other income of $27 in the second quarter and $86 for the first six months of 2011. Income in the second quarter and for the first six months of 2012 included interest and dividend income of $19 and $34, leveraged lease income of $8 and $41 and a net loss on the sale of investments of $11 and $1, respectively.

Other income in the second quarter and for the first six months of 2011 included interest and dividend income of $30 and $43 and leveraged lease income of $4 and $11, respectively. Income for the first six months of 2011 also included a net gain of $28 from appreciation and sale of investments.

Income taxes increased $173, or 9.1%, in the second quarter and $236, or 6.4%, for the first six months of 2012 as a result of increased income before income taxes. Our effective tax rate was 34.3% for the second quarter and 34.0% for the first six months of 2012, as compared to 34.1% for both the second quarter and the first six months of 2011.

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Selected Financial and Operating Data

	June 30,	
	2012	2011
Wireless subscribers (000)	105,206	98,615
Network access lines in service (000)	34,274	39,275
Total wireline broadband connections (000)	16,434	16,473
Debt ratio[1]	38.4 %	36.8 %
Ratio of earnings to fixed charges[2]	5.36	5.40
Number of AT&T employees	242,380	258,870

1 Debt ratios are calculated by dividing total debt (debt maturing within one year plus long-term debt) by total capital (total debt plus total stockholders' equity) and do not consider cash available to pay down debt. See our "Liquidity and Capital Resources" section for discussion.
2 See Exhibit 12.

Segment Results

Our segments are strategic business units that offer different products and services over various technology platforms and are managed accordingly. Our operating segment results presented in Note 3 and discussed below for each segment follow our internal management reporting. We analyze our various operating segments based on segment income before income taxes. We make our capital allocations decisions based on our strategic direction of the business, needs of the network (wireless or wireline) providing services and other assets needed to provide emerging services to our customers. Actuarial gains and losses from pension and other postretirement benefits, interest expense and other income (expense) – net, are managed only on a total company basis and are, accordingly, reflected only in consolidated results. We have four reportable segments: (1) Wireless, (2) Wireline, (3) Advertising Solutions and (4) Other.

The Wireless segment uses our nationwide network to provide consumer and business customers with wireless voice and advanced data communications services. The Wireless segment results have been reclassified to include the operating results of a subsidiary that provides services for subscribers to wirelessly monitor their homes that was previously reported in the Wireline segment's results.

The Wireline segment uses our regional, national and global network to provide consumer and business customers with landline voice and data communications services, U-verse TV, high-speed broadband and voice services and managed networking to business customers. Additionally, we receive commissions on sales of satellite television services offered through our agency arrangements. The Wireline segment results have been reclassified to exclude the operating results of the business moved to our Wireless segment and to include the operating results of customer information services, which were previously reported in our Other segment's results.

The Advertising Solutions segment includes our directory operations, which publish Yellow and White Pages directories and sells directory advertising and Internet-based advertising and local search through May 8, 2012 (see Note 1).

The Other segment includes our portion of the results from our international equity investments, our 47 percent equity interest in YP Holdings, and all corporate and other operations. Also included in the Other segment are impacts of corporate-wide decisions for which the individual operating segments are not being evaluated, including interest cost and expected return on plan assets for our pension and postretirement benefit plans. The Other segment results have been reclassified to exclude the operating results of customer information services, which are now reported in our Wireline segment's results.

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Operations and support expenses include bad debt expense; advertising costs; sales and marketing functions, including customer service centers; real estate costs, including maintenance and utilities on all buildings; credit and collection functions; and corporate support costs, such as finance, legal, human resources and external affairs. Pension and postretirement service costs, net of amounts capitalized as part of construction labor, are also included to the extent that they are associated with these employees. Our Wireless and Wireline segments also include certain network planning and engineering expenses, information technology, our repair technicians and repair services, and property taxes as operations and support expenses.

The following tables show components of results of operations by segment. Significant segment results are discussed following each table. Capital expenditures for each segment are discussed in "Liquidity and Capital Resources."

Wireless
Segment Results

	Second Quarter		Six-Month Period
	2012	2011	