

AT&T INC.
Form 10-Q
August 06, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

or

- 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 []

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Large accelerated
filer

Non-accelerated [] (Do not check if a smaller reporting Smaller reporting []
filer company) 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, 2010, there were 5,909 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, | | Six months ended June 30, | |
|--|--------------------------------|-----------|------------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Operating Revenues | | | | |
| Wireless service | \$ 13,186 | \$ 11,960 | \$ 26,036 | \$ 23,606 |
| Voice | 7,219 | 8,255 | 14,698 | 16,758 |
| Data | 6,848 | 6,323 | 13,479 | 12,605 |
| Directory | 1,007 | 1,211 | 2,048 | 2,460 |
| Other | 2,548 | 2,865 | 5,077 | 5,642 |
| Total operating revenues | 30,808 | 30,614 | 61,338 | 61,071 |
| Operating Expenses | | | | |
| Cost of services and sales (exclusive of depreciation and amortization shown separately below) | 12,381 | 12,557 | 24,716 | 24,758 |
| Selling, general and administrative | 7,475 | 7,682 | 14,863 | 15,340 |
| Depreciation and amortization | 4,838 | 4,875 | 9,638 | 9,733 |
| Total operating expenses | 24,694 | 25,114 | 49,217 | 49,831 |
| Operating Income | 6,114 | 5,500 | 12,121 | 11,240 |
| Other Income (Expense) | | | | |
| Interest expense | (754) | (876) | (1,519) | (1,722) |
| Equity in net income of affiliates | 195 | 231 | 412 | 368 |
| Other income (expense) – net | 723 | 30 | 700 | 15 |
| Total other income (expense) | 164 | (615) | (407) | (1,339) |
| Income from Continuing Operations Before Income Taxes | 6,278 | 4,885 | 11,714 | 9,901 |
| Income taxes | 2,173 | 1,612 | 5,048 | 3,423 |
| Income from Continuing Operations | 4,105 | 3,273 | 6,666 | 6,478 |
| Income (Loss) from Discontinued Operations, net of tax | (4) | 3 | (3) | (1) |
| Net Income | 4,101 | 3,276 | 6,663 | 6,477 |
| Less: Net Income Attributable to Noncontrolling Interest | (78) | (78) | (165) | (153) |
| Net Income Attributable to AT&T | \$ 4,023 | \$ 3,198 | \$ 6,498 | \$ 6,324 |
| Basic Earnings Per Share from Continuing Operations | | | | |
| Attributable to AT&T | \$ 0.68 | \$ 0.54 | \$ 1.10 | \$ 1.07 |
| Basic Earnings Per Share from Discontinued Operations | | | | |
| Attributable to AT&T | - | - | - | - |
| Basic Earnings Per Share Attributable to AT&T | \$ 0.68 | \$ 0.54 | \$ 1.10 | \$ 1.07 |
| Diluted Earnings Per Share from Continuing Operations | | | | |
| Attributable to AT&T | \$ 0.68 | \$ 0.54 | \$ 1.10 | \$ 1.07 |
| Diluted Earnings Per Share from Discontinued Operations | | | | |
| Attributable to AT&T | - | - | - | - |
| Diluted Earnings Per Share Attributable to AT&T | \$ 0.68 | \$ 0.54 | \$ 1.10 | \$ 1.07 |
| Weighted Average Number of Common Shares Outstanding | | | | |
| – Basic (in millions) | 5,909 | 5,900 | 5,907 | 5,898 |

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| | | | | |
|--|--------|--------|--------|--------|
| Weighted Average Number of Common Shares Outstanding | | | | |
| – with Dilution (in millions) | 5,937 | 5,923 | 5,936 | 5,923 |
| Dividends Declared Per Common Share | \$0.42 | \$0.41 | \$0.84 | \$0.82 |

See Notes to Consolidated Financial Statements.

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AT&T INC.

CONSOLIDATED BALANCE SHEETS

Dollars in millions except per share amounts

| | June 30, 2010 (Unaudited) | December 31, 2009 |
|---|---------------------------------|-------------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$1,377 | \$3,741 |
| Accounts receivable – net of allowances for doubtful accounts of \$1,084 and \$1,202 | 13,780 | 14,845 |
| Prepaid expenses | 1,666 | 1,562 |
| Deferred income taxes | 1,225 | 1,247 |
| Other current assets | 3,344 | 3,792 |
| Total current assets | 21,392 | 25,187 |
| Property, plant and equipment | 236,187 | 230,295 |
| Less: accumulated depreciation and amortization | (135,885) | (130,242) |
| Property, Plant and Equipment – Net | 100,302 | 100,053 |
| Goodwill | 73,484 | 72,782 |
| Licenses | 49,957 | 48,741 |
| Customer Lists and Relationships – Net | 6,047 | 7,393 |
| Other Intangible Assets – Net | 5,539 | 5,494 |
| Investments in Equity Affiliates | 4,346 | 2,921 |
| Other Assets | 6,489 | 6,275 |
| Total Assets | \$267,556 | \$268,846 |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities | | |
| Debt maturing within one year | \$9,721 | \$7,361 |
| Accounts payable and accrued liabilities | 18,157 | 21,260 |
| Advanced billing and customer deposits | 3,943 | 4,170 |
| Accrued taxes | 1,879 | 1,681 |
| Dividends payable | 2,482 | 2,479 |
| Total current liabilities | 36,182 | 36,951 |
| Long-Term Debt | 60,277 | 64,720 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 25,615 | 23,781 |
| Postemployment benefit obligation | 27,421 | 27,847 |
| Other noncurrent liabilities | 14,578 | 13,226 |
| Total deferred credits and other noncurrent liabilities | 67,614 | 64,854 |
| Stockholders' Equity | | |
| Common stock (\$1 par value, 14,000,000,000 authorized at June 30, 2010 and December 31, 2009; issued 6,495,231,088 at June 30, 2010 and December 31, 2009) | 6,495 | 6,495 |
| Additional paid-in capital | 91,628 | 91,707 |
| Retained earnings | 40,909 | 39,366 |
| Treasury stock (586,184,637 at June 30, 2010 and 593,300,187 at December 31, 2009, at cost) | (21,134) | (21,260) |
| Accumulated other comprehensive loss | (14,852) | (14,412) |
| Noncontrolling interest | 437 | 425 |

| | | |
|--|-----------|-----------|
| Total stockholders' equity | 103,483 | 102,321 |
| Total Liabilities and Stockholders' Equity | \$267,556 | \$268,846 |

See Notes to Consolidated Financial Statements.

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AT&T INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in millions, increase (decrease) in cash and cash equivalents

(Unaudited)

| | Six months ended June 30, | |
|--|------------------------------|----------|
| | 2010 | 2009 |
| Operating Activities | | |
| Net income | \$6,663 | \$6,477 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 9,638 | 9,733 |
| Undistributed earnings from investments in equity affiliates | (378) | (339) |
| Bad debt expense | 671 | 975 |
| Deferred income tax expense | 2,076 | 746 |
| Net (gain) loss from impairment and sale of investments | (641) | 92 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 394 | 169 |
| Other current assets | 389 | (58) |
| Accounts payable and accrued liabilities | (3,063) | (2,054) |
| Net income attributable to noncontrolling interest | (165) | (153) |
| Other - net | 226 | 184 |
| Total adjustments | 9,147 | 9,295 |
| Net Cash Provided by Operating Activities | 15,810 | 15,772 |
| Investing Activities | | |
| Construction and capital expenditures | | |
| Capital expenditures | (7,856) | (7,017) |
| Interest during construction | (379) | (368) |
| Acquisitions, net of cash acquired | (2,554) | (55) |
| Dispositions | 14 | 199 |
| (Purchases) and sales of securities, net | (545) | 4 |
| Other | 17 | 14 |
| Net Cash Used in Investing Activities | (11,303) | (7,223) |
| Financing Activities | | |
| Net change in short-term borrowings with original maturities of three months or less | 3,280 | (3,915) |
| Issuance of long-term debt | - | 8,161 |
| Repayment of long-term debt | (4,661) | (2,036) |
| Issuance of treasury stock | 5 | 4 |
| Dividends paid | (4,960) | (4,834) |
| Other | (535) | (381) |
| Net Cash Used in Financing Activities | (6,871) | (3,001) |
| Net increase (decrease) in cash and cash equivalents | (2,364) | 5,548 |
| Cash and cash equivalents beginning of year | 3,741 | 1,727 |
| Cash and Cash Equivalents End of Period | \$1,377 | \$7,275 |
| Cash paid during the six months ended June 30 for: | | |
| Interest | \$2,390 | \$2,219 |

| | | |
|---|---------|---------|
| Income taxes, net of refunds | \$2,449 | \$2,295 |
| See Notes to Consolidated Financial Statements. | | |

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AT&T Inc.

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

Dollars and shares in millions except per share amounts

| | | June 30, 2010 | |
|---|--------|---------------|-----------|
| | Shares | | Amount |
| Common Stock | | | |
| Balance at beginning of year | 6,495 | \$ | 6,495 |
| Balance at end of period | 6,495 | \$ | 6,495 |
| Additional Paid-In Capital | | | |
| Balance at beginning of year | | \$ | 91,707 |
| Issuance of treasury shares | | | 68 |
| Share-based payments | | | (147) |
| Balance at end of period | | \$ | 91,628 |
| Retained Earnings | | | |
| Balance at beginning of year | | \$ | 39,366 |
| Net income attributable to AT&T (\$1.10 per share) | | | 6,498 |
| Dividends to stockholders (\$0.84 per share) | | | (4,963) |
| Other | | | 8 |
| Balance at end of period | | \$ | 40,909 |
| Treasury Stock | | | |
| Balance at beginning of year | (593) | \$ | (21,260) |
| Issuance of shares | 7 | | 126 |
| Balance at end of period | (586) | \$ | (21,134) |
| Accumulated Other Comprehensive Income (Loss) | | | |
| Attributable to AT&T, net of tax: | | | |
| Balance at beginning of year | | \$ | (14,412) |
| Other comprehensive income attributable to AT&T (see Note 2) | | | (440) |
| Balance at end of period | | \$ | (14,852) |
| Noncontrolling Interest: | | | |
| Balance at beginning of year | | \$ | 425 |
| Net income attributable to noncontrolling interest | | | 165 |
| Distributions | | | (151) |
| Translation adjustments applicable to noncontrolling interest, net of taxes | | | (2) |
| Balance at end of period | | \$ | 437 |
| Total Stockholders' Equity at beginning of year | | \$ | 102,321 |
| Total Stockholders' Equity at end of period | | \$ | 103,483 |

See Notes to Consolidated Financial Statements.

AT&T INC.
JUNE 30, 2010

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Dollars in millions except per share amounts

NOTE 1. PREPARATION OF INTERIM FINANCIAL STATEMENTS

Basis of Presentation Throughout this document, AT&T Inc. is referred to as “AT&T,” “we” or the “Company.” The consolidated financial statements have been prepared pursuant to Regulation S-X and other applicable rules of the Securities and Exchange Commission that permit reduced disclosures for interim reporting. 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, 2009.

In preparing the accompanying unaudited consolidated financial statements, we have reviewed all known events that have occurred after June 30, 2010, and through the date that our Form 10-Q was available for issuance for possible inclusion in this Form 10-Q (see Note 8).

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

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.

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—see Note 4 for a discussion of our change in approach to intersegment activity, effective January 1, 2010, and see Note 7 for a discussion of changes in reporting related to discontinued operations.

Recent Accounting Standards

Fair Value Measurements and Disclosures In January 2010, the FASB issued “Fair Value Measurements and Disclosures—Improving Disclosures about Fair Value Measurements” (Accounting Standards Update (ASU) 2010-06), which requires new disclosures and explanations for transfers of financial assets and liabilities between certain levels in the fair value hierarchy. ASU 2010-06 also clarifies that fair value measurement disclosures are required for each class of financial asset and liability, which may be a subset of a caption in the consolidated balance sheets, and those disclosures should include a discussion of inputs and valuation techniques. For financial assets and liabilities subject to lowest-level measurements, ASU 2010-06 further requires that we separately present purchases, sales, issuances, and settlements instead of netting these changes. With respect to matters other than lowest-level measurements, we adopted ASU 2010-06 beginning with the quarter ended March 31, 2010, with the remaining disclosure requirements

becoming effective for fiscal years and interim periods beginning on or after December 15, 2010 (i.e., the quarter ending March 31, 2011, for us). See Note 6 for fair value measurements and disclosures for our investment securities and derivatives.

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AT&T INC.
JUNE 30, 2010

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

Valuation and Other Adjustments Included in the current liabilities reported on our consolidated balance sheets are acquisition-related accruals established prior to 2009. The liabilities include accruals for severance, lease terminations and equipment removal costs associated with our acquisitions of AT&T Corp., BellSouth Corporation (BellSouth), and Dobson Communications Corporation (Dobson). Following is a summary of the accruals recorded at December 31, 2009, cash payments made during 2010, and the adjustments thereto:

| | 12/31/09 Balance | Cash Payments | Adjustments and Accruals | 6/30/10 Balance |
|--|---------------------|------------------|--------------------------------|--------------------|
| Severance accruals paid from: | | | | |
| Company funds | \$ 6 | \$ (2) | \$ (2) | \$ 2 |
| Pension and postemployment benefit plans | 98 | (2) | - | 96 |
| Lease terminations ¹ | 212 | (19) | (61) | 132 |
| Equipment removal and other related costs ¹ | 23 | (1) | (20) | 2 |
| Total | \$ 339 | \$ (24) | \$ (83) | \$ 232 |

¹The "Adjustments and Accruals" related to the BellSouth and Dobson acquisitions and resulted in goodwill reductions.

Employee Separations We establish obligations for expected termination benefits provided under existing plans to former or inactive employees after employment but before retirement. These benefits include severance payments, workers' compensation, disability, medical continuation coverage, and other benefits. We had severance accruals of \$290 at June 30, 2010 and \$676 at December 31, 2009. The decrease in balance was due to payments during the period.

Income Taxes In March 2010, the President of the United States signed into law comprehensive health care reform legislation under the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, which included a change in the tax treatment related to Medicare Part D subsidies. We recorded a \$995, or \$0.17 per diluted share, charge to income tax expense in our consolidated statement of income during the first quarter of 2010 and increased our deferred income taxes liability balance to reflect the impact of this change. The charge also contributed to an increase in our effective tax rate to 43.1% for the six months ended June 30, 2010, compared to 34.6% for the same period in 2009.

AT&T INC.
JUNE 30, 2010

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

NOTE 2. COMPREHENSIVE INCOME

The components of our comprehensive income for the three and six months ended June 30, 2010 and 2009 include net income, foreign currency translation adjustments and net unrealized gains (losses) on available-for-sale securities, net unrealized gains (losses) on cash flow hedges and defined benefit postretirement plans. The foreign currency translation adjustment was due to exchange rate fluctuations in our foreign affiliates' local currencies and the reclassification adjustment on cash flow hedges was due to the amortization of losses from our interest rate locks.

Following is our comprehensive income with the respective tax impacts for the three months and six months periods ended June 30, 2010 and 2009:

| | Three months ended June 30, | | Six months ended June 30, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 4,101 | \$ 3,276 | \$ 6,663 | \$ 6,477 |
| Other comprehensive income, net of tax: | | | | |
| Foreign currency translation adjustments (includes \$(1), \$(1), \$(2) and \$(8) attributable to noncontrolling interest), net of taxes of \$12, \$63, \$62 and \$43 | 22 | 119 | 115 | 82 |
| Net unrealized gains (losses) on securities: | | | | |
| Unrealized gains (losses), net of taxes of \$(62), \$63, \$(14) and \$15 | (115) | 119 | (25) | 29 |
| Less reclassification adjustment realized in net income, net of taxes of \$(16), \$0, \$(29) and \$41 | (30) | - | (55) | 77 |
| Net unrealized gains (losses) on cash flow hedges: | | | | |
| Unrealized gains (losses) on rate locks and cross currency swaps net of taxes of \$(257), \$128, \$(273) and \$224 | (472) | 234 | (502) | 418 |
| Reclassification adjustment for losses on cash flow hedges included in net income, net of taxes of \$2, \$1, \$4 and \$4 | 3 | 4 | 6 | 7 |
| Defined benefit postretirement plans: | | | | |
| Amortization of net actuarial gain and prior service cost included in net income, net of taxes of \$5, \$37, \$11 and \$67 | 8 | 69 | 19 | 126 |
| Other | - | 1 | - | - |
| Other comprehensive income (loss) | (584) | 546 | (442) | 739 |
| Total comprehensive income | 3,517 | 3,822 | 6,221 | 7,216 |
| | (77) | (77) | (163) | (145) |

| | | | | |
|--|----------|----------|----------|----------|
| Less: Total comprehensive income attributable to noncontrolling interest | | | | |
| Total Comprehensive Income Attributable to AT&T | \$ 3,440 | \$ 3,745 | \$ 6,058 | \$ 7,071 |

AT&T INC.
JUNE 30, 2010

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

NOTE 3. 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, 2010 and 2009, are shown in the table below:

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|---------|------------------------------|---------|
| | 2010 | 2009 | 2010 | 2009 |
| Numerators | | | | |
| Numerator for basic earnings per share: | | | | |
| Net income attributable to AT&T | \$4,023 | \$3,198 | \$6,498 | \$6,324 |
| Dilutive potential common shares: | | | | |
| Other share-based payment | 2 | 2 | 4 | 5 |
| Numerator for diluted earnings per share | \$4,025 | \$3,200 | \$6,502 | \$6,329 |
| Denominators (000,000) | | | | |
| Denominator for basic earnings per share: | | | | |
| Weighted-average number of common shares outstanding | 5,909 | 5,900 | 5,907 | 5,898 |
| Dilutive potential common shares: | | | | |
| Stock options | 3 | 3 | 3 | 3 |
| Other share-based payment | 25 | 20 | 26 | 22 |
| Denominator for diluted earnings per share | 5,937 | 5,923 | 5,936 | 5,923 |
| Basic earnings per share attributable to AT&T | \$0.68 | \$0.54 | \$1.10 | \$1.07 |
| Diluted earnings per share attributable to AT&T | \$0.68 | \$0.54 | \$1.10 | \$1.07 |

At June 30, 2010, we had issued and outstanding options to purchase approximately 143 million shares of AT&T common stock. The exercise prices of 127 million shares were above the market price of AT&T stock at June 30, 2010. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the period. At June 30, 2010, the exercise prices of 12 million stock options were below market price.

At June 30, 2009, we had issued and outstanding options to purchase approximately 183 million shares of AT&T common stock. The exercise prices of 164 million shares were above the market price of AT&T stock at June 30, 2009. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the period. At June 30, 2009, the exercise prices of 16 million stock options were below market price.

AT&T INC.
JUNE 30, 2010

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

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services over various technology platforms and are managed accordingly. We analyze our various operating segments based on segment income before income taxes. Interest expense and other income (expense) – net are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in the calculation of each segment's percentage of our consolidated results. 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 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-verseSM TV, high-speed broadband and voice services (U-verse) and managed networking to business customers. Additionally, we receive commissions on sales of satellite television services offered through our agency arrangements.

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.

The Other segment includes results from customer information services and all corporate and other operations. This segment includes our portion of the results from our international equity investments. Also included in the Other segment are impacts of corporate-wide decisions for which the individual operating segments are not being evaluated. In May 2010, we announced the sale of Sterling Commerce Inc. (Sterling). The Other segment results for all periods shown have been restated to exclude the results of Sterling, which are now reflected in discontinued operations (see Note 7).

Historically, the intersegment activity had been reported as revenue in the billing segment and offsetting operating expense in the purchasing segment. Upon consolidation, the intersegment revenue and expense were eliminated with the consolidated results reflecting the cash operating and depreciation expense of providing the intersegment service. As part of AT&T's ongoing initiatives to manage its business from an external customer perspective, we no longer report intersegment revenue and instead report the cash operating and depreciation expense related to intersegment activity in the purchasing segment which provided services to the external customer. While this change did not impact AT&T's total consolidated results, the impact to each operating segment varied. In particular, the Wireless segment, as a purchaser of network, IT and other services from the Wireline segment, experienced a reduction in cash operating expense partially offset by increased depreciation expense with the net result being increased operating margins. This change was effective with the reporting of operating results for the quarter ended March 31, 2010. We have restated prior-period segment information to conform to the current period's presentation.

In the following tables, we show how our segment results are reconciled to our consolidated results reported. The Wireless, Wireline, Advertising Solutions and Other columns represent the segment results of each such operating segment. The consolidation column adds in those line items that we manage on a consolidated basis only: interest

expense and other income (expense) – net.

Segment assets as of June 30, 2010 are materially unchanged from the year ended December 31, 2009 with the exception of Wireless segment assets. Our Wireless segment assets totaled \$119,496, which increased \$2,969, or 2.5%, primarily due to increases in goodwill and licenses related to purchase of certain Verizon Wireless properties (See Note 7).

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AT&T INC.
JUNE 30, 2010

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

For the three months ended June 30, 2010

| | Wireless | Wireline | Advertising Solutions | Other | Consolidations | Consolidated Results |
|--|-----------|-----------|-----------------------|--------|----------------|----------------------|
| Total segment operating revenues | \$ 14,242 | \$ 15,396 | \$ 1,007 | \$ 163 | \$ - | \$ 30,808 |
| Operations and support expenses | 8,562 | 10,389 | 673 | 232 | - | 19,856 |
| Depreciation and amortization expenses | 1,578 | 3,123 | 132 | 5 | - | 4,838 |
| Total segment operating expenses | 10,140 | 13,512 | 805 | 237 | - | 24,694 |
| Segment operating income (loss) | 4,102 | 1,884 | 202 | (74) | - | 6,114 |
| Interest expense | - | - | - | - | 754 | 754 |
| Equity in net income of affiliates | 7 | - | - | 188 | - | 195 |
| Other income | - | - | - | - | 723 | 723 |
| Segment income before income taxes | \$ 4,109 | \$ 1,884 | \$ 202 | \$ 114 | \$ (31) | \$ 6,278 |

For the six months ended June 30, 2010

| | Wireless | Wireline | Advertising Solutions | Other | Consolidations | Consolidated Results |
|--|-----------|-----------|-----------------------|--------|----------------|----------------------|
| Total segment operating revenues | \$ 28,139 | \$ 30,817 | \$ 2,048 | \$ 334 | \$ - | \$ 61,338 |
| Operations and support expenses | 16,745 | 21,006 | 1,348 | 480 | - | 39,579 |
| Depreciation and amortization expenses | 3,136 | 6,219 | 270 | 13 | - | 9,638 |
| Total segment operating expenses | 19,881 | 27,225 | 1,618 | 493 | - | 49,217 |
| Segment operating income (loss) | 8,258 | 3,592 | 430 | (159) | - | 12,121 |
| Interest expense | - | - | - | - | 1,519 | 1,519 |
| Equity in net income of affiliates | 20 | 5 | - | 387 | - | 412 |
| Other income | - | - | - | - | 700 | 700 |
| Segment income before income taxes | \$ 8,278 | \$ 3,597 | \$ 430 | \$ 228 | \$ (819) | \$ 11,714 |

AT&T INC.
JUNE 30, 2010

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

For the three months ended June 30, 2009

| | Wireless | Wireline | Advertising Solutions | Other | Consolidations | Consolidated Results |
|--|-----------|-----------|--------------------------|--------|----------------|-------------------------|
| Total segment operating revenues | \$ 13,222 | \$ 15,989 | \$ 1,211 | \$ 192 | \$ - | \$ 30,614 |
| Operations and support expenses | 8,428 | 10,924 | 706 | 181 | - | 20,239 |
| Depreciation and amortization expenses | 1,504 | 3,194 | 166 | 11 | - | 4,875 |
| Total segment operating expenses | 9,932 | 14,118 | 872 | 192 | - | 25,114 |
| Segment operating income (loss) | 3,290 | 1,871 | 339 | - | - | 5,500 |
| Interest expense | - | - | - | - | 876 | 876 |
| Equity in net income of affiliates | - | 5 | - | 226 | - | 231 |
| Other income (expense) – net | - | (1) | - | - | 31 | 30 |
| Segment income before income taxes | \$ 3,290 | \$ 1,875 | \$ 339 | \$ 226 | \$ (845) | \$ 4,885 |

For the six months ended June 30, 2009

| | Wireless | Wireline | Advertising Solutions | Other | Consolidations | Consolidated Results |
|--|-----------|-----------|--------------------------|--------|----------------|-------------------------|
| Total segment operating revenues | \$ 26,060 | \$ 32,151 | \$ 2,460 | \$ 400 | \$ - | \$ 61,071 |
| Operations and support expenses | 16,314 | 21,856 | 1,427 | 501 | - | 40,098 |
| Depreciation and amortization expenses | 3,003 | 6,368 | 342 | 20 | - | 9,733 |
| Total segment operating expenses | 19,317 | 28,224 | 1,769 | 521 | - | 49,831 |
| Segment operating income (loss) | 6,743 | 3,927 | 691 | (121) | - | 11,240 |
| Interest expense | - | - | - | - | 1,722 | 1,722 |
| Equity in net income of affiliates | - | 8 | - | 360 | - | 368 |
| Other income (expense) – net | - | (1) | - | - | 16 | 15 |
| Segment income before income taxes | \$ 6,743 | \$ 3,934 | \$ 691 | \$ 239 | \$ (1,706) | \$ 9,901 |

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

NOTE 5. 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 substantially all 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 2010.

The following details pension and postretirement benefit costs included in operating expenses (in cost of sales and selling, general and administrative expenses) in the accompanying Consolidated Statements of Income. In the following table, gains are denoted with parentheses. A portion of these expenses is capitalized as part of the benefit load on internal construction and capital expenditures, historically averaging approximately 10%.

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Pension (benefit) cost: | | | | |
| Service cost – benefits earned during the period | \$ 269 | \$ 272 | \$ 538 | \$ 544 |
| Interest cost on projected benefit obligation | 788 | 845 | 1,575 | 1,690 |
| Expected return on assets | (1,143) | (1,141) | (2,286) | (2,281) |
| Amortization of prior service (benefit) cost | (4) | 28 | (8) | 55 |
| Recognized actuarial loss | 171 | 166 | 342 | 332 |
| Net pension cost | \$ 81 | \$ 170 | \$ 161 | \$ 340 |
| Postretirement (benefit) cost: | | | | |
| Service cost – benefits earned during the period | \$ 87 | \$ 88 | \$ 174 | \$ 176 |
| Interest cost on accumulated postretirement benefit obligation | 566 | 631 | 1,129 | 1,261 |
| Expected return on assets | (285) | (239) | (569) | (478) |
| Amortization of prior service benefit | (157) | (89) | (313) | (179) |
| Recognized actuarial gain | (1) | - | (3) | - |
| Postretirement cost | \$ 210 | \$ 391 | \$ 418 | \$ 780 |
| Combined net pension and postretirement cost | \$ 291 | \$ 561 | \$ 579 | \$ 1,120 |

Our combined net pension and postretirement cost decreased \$270 in the second quarter and \$541 for the first six months of 2010. The decrease was primarily related to lower interest costs due to a lower net obligation, as a result of retiree medical and drug coverage changes, partially offset by a change in the discount rate from 7% to 6.5%. An increase in amortization of prior service benefit, driven by the utilization of market interest rates for lump sum pension distributions, under the Pension Protection Act and changes in future retiree benefits, also contributed to the decrease in combined net pension and postretirement cost. We use a method in which gains and losses are amortized only when the net gains or losses exceed 10% of the greater of the projected benefit obligation or the market-related value of assets (MRVA). The expected long-term rate of return is calculated on the MRVA. Actual gains and losses on pension and postretirement plan assets are generally recognized in the MRVA equally over a period of up to five years. However, we use a methodology under which we hold the MRVA to within 20% of the actual fair value of plan assets, which can have the effect of accelerating the recognition of excess actual gains and losses in the MRVA in less than five years. Due to investment losses on plan assets experienced in 2008, this methodology contributed \$1,577 to our combined net pension and postretirement costs in 2009. This methodology will not have a material impact on our combined net pension and postretirement cost in 2010.

We have varying types of pension programs providing benefits for substantially all of certain non-U.S. operations. In addition to the pension and postretirement costs above, we recorded net pension cost for non-U.S. plans of (\$1) in the second quarter and \$1 for the first six months of 2010 and (\$4) in the second quarter and (\$3) for the first six months of 2009.

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

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 \$42 in the second quarter, of which \$33 was interest cost, and \$84 for the first six months of 2010, of which \$67 was interest cost. In 2009, net supplemental retirement pension benefits cost was \$41 in the second quarter, \$35 of which was interest cost, and \$83 for the first six months, \$70 of which was interest cost.

NOTE 6. 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 AT&T has 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.
- If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.
- Fair value is often based on internally developed models in which there are few, if any, external observations.

The asset's or liability's fair value measurement level 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. AT&T believes its 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 at June 30, 2010 and December 31, 2009.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

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, 2010 | | December 31, 2009 | |
|-----------------------|--------------------|---------------|----------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Notes and debentures | \$ 66,448 | \$ 72,447 | \$ 71,811 | \$ 75,212 |
| Commercial paper | 3,278 | 3,278 | - | - |
| Bank borrowings | 35 | 35 | 33 | 33 |
| Investment securities | 2,132 | 2,132 | 1,885 | 1,885 |

The fair values of our notes and debentures were estimated based on quoted market prices, where available, or on the net present value method of expected future cash flows using current interest rates. The carrying value of debt with an original maturity of less than one year approximates market value.

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. Realized gains and losses on these 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.

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, 2010 and December 31, 2009:

| | June 30, 2010 | | | Total |
|-------------------------------|---------------|---------|---------|--------|
| | Level 1 | Level 2 | Level 3 | |
| Available-for-Sale Securities | | | | |
| Domestic equities | \$ 942 | \$ - | \$ - | \$ 942 |
| International equities | 395 | - | - | 395 |

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| | | | | |
|----------------------------|---|----------|---|----------|
| Fixed income bonds | - | 690 | - | 690 |
| Asset Derivatives | | | | |
| Interest rate swaps | - | 602 | - | 602 |
| Cross-currency swaps | - | 108 | - | 108 |
| Foreign exchange contracts | - | 5 | - | 5 |
| Liability Derivatives | | | | |
| Cross-currency swaps | - | (1,014) | - | (1,014) |
| Interest rate locks | - | (290) | - | (290) |
| Foreign exchange contracts | - | (21) | - | (21) |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

| | December 31, 2009 | | | Total |
|-------------------------------|-------------------|---------|---------|----------|
| | Level 1 | Level 2 | Level 3 | |
| Available-for-Sale Securities | | | | |
| Domestic equities | \$ 1,047 | \$ - | \$ - | \$ 1,047 |
| International equities | 412 | - | - | 412 |
| Fixed income bonds | - | 341 | - | 341 |
| Asset Derivatives | | | | |
| Interest rate swaps | - | 399 | - | 399 |
| Cross-currency swaps | - | 635 | - | 635 |
| Interest rate locks | - | 150 | - | 150 |
| Foreign exchange contracts | - | 2 | - | 2 |
| Liability Derivatives | | | | |
| Cross-currency swaps | - | (390) | - | (390) |
| Interest rate locks | - | (6) | - | (6) |
| Foreign exchange contracts | - | (7) | - | (7) |

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 which 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). Only a portion of our foreign exchange forward contracts is not designated to receive hedge accounting.

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. We record changes in the fair value of the swaps, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. 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, though they net to zero. Realized gains or losses upon early termination of our fair value hedges

would be recognized in interest expense.

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 in other income - 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, 2010 and June 30, 2009, no ineffectiveness was measured.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

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. In the second quarter, we settled \$200 of notional rate locks without utilizing them in a debt issuance. The total impact to interest expense was \$(5). We are confident our remaining rate locks will be utilized given our probable refinancing needs over the next two years. No other ineffectiveness was measured in the six months ended June 30, 2010. Over the next 12 months, we expect to reclassify \$16 from accumulated OCI to interest expense due to the amortization of net losses on historical interest rate locks. Our unutilized interest rate locks carry mandatory early terminations, the latest occurring in April 2012.

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 non-designated, 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 over the next few months as the hedged funds are spent by our foreign subsidiaries, except where a material amount is deemed to be ineffective, which would be immediately reclassified to income. In the six months ended June 30, 2010, no ineffectiveness was measured. No transactions were designated in the first half of 2009.

Non-designated and Discontinued Hedging Instruments Changes in the fair value of non-designated derivatives are recorded in other income (expense) – net, along with the change in fair value of the underlying asset or liability, as applicable. When hedge accounting is discontinued, the derivative is adjusted for changes in fair value through other income (expense) – net. For fair value hedges, the swap asset or liability and the underlying hedged liability or asset will no longer be adjusted for changes in fair value, and the net adjustment to the hedged item at that time will be amortized into earnings over the remaining life of the hedged item. For cash flow hedges, gains and losses that were in accumulated OCI as a component of stockholders' equity in connection with hedged assets or liabilities or forecasted transactions will be recognized in other income (expense) - net, in the same period the hedged item affects earnings.

Collateral and Credit-Risk Contingency We have entered into agreements with most of our derivative counterparties, establishing collateral thresholds based on respective credit ratings and netting agreements. At June 30, 2010, we had posted collateral of \$168 (a deposit asset). Under the agreements, if our credit rating had been downgraded one rating level, we would have been required to post additional collateral of \$232. At December 31, 2009, we held \$222 of counterparty collateral. 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, 2010 | December 31, 2009 |
|---------------------|------------------|-------------------------|
| Interest rate swaps | \$ 11,250 | \$ 9,000 |

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| | | |
|----------------------------|-----------|-----------|
| Cross-currency swaps | 7,502 | 7,502 |
| Interest rate locks | 3,400 | 3,600 |
| Foreign exchange contracts | 229 | 293 |
| Total | \$ 22,381 | \$ 20,395 |

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

Following are our derivative instruments and their related hedged items affecting our financial position and performance:

Fair Value of Derivatives in the Consolidated Balance Sheets

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

| | June 30, 2010 | December 31, 2009 |
|----------------------------|------------------|-------------------------|
| Asset Derivatives | | |
| Interest rate swaps | \$ 602 | \$ 399 |
| Cross-currency swaps | 108 | 635 |
| Interest rate locks | - | 150 |
| Foreign exchange contracts | 5 | 2 |
| Total | \$ 715 | \$ 1,186 |

| | June 30, 2010 | December 31, 2009 |
|----------------------------|------------------|-------------------------|
| Liability Derivatives | | |
| Cross-currency swaps | \$ (1,014) | \$ (390) |
| Interest rate locks | (290) | (6) |
| Foreign exchange contracts | (21) | (7) |
| Total | \$ (1,325) | \$ (403) |

Effect of Derivatives on the Consolidated Statements of Income

| | Three months ended June 30, 2010 | Three months ended June 30, 2009 | Six months ended June 30, 2010 | Six months ended June 30, 2009 |
|---|--|--|---|---|
| Fair Value Hedging Relationships | | | | |
| Interest rate swaps (Interest expense): | | | | |
| Gain (Loss) on interest rate swaps | \$ 142 | \$ (169) | \$ 194 | \$ (220) |
| Gain (Loss) on long-term debt | (142) | 169 | (194) | 220 |

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 | Three months ended | Six months ended | Six months ended |
|--|--------------------------|--------------------------|---------------------|---------------------|
| | | | | |

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| Cash Flow Hedging Relationships | June 30, 2010 | June 30, 2009 | June 30, 2010 | June 30, 2009 |
|---|-------------------------------------|-------------------------------------|-----------------------------------|-----------------------------------|
| Cross-currency swaps: | | | | |
| Gain (Loss) recognized in accumulated OCI | \$ (345) | \$ 343 | \$ (324) | \$ 563 |
| Other income (expense) reclassified from accumulated OCI into income | - | - | - | - |
| Interest rate locks: | | | | |
| Gain (Loss) recognized in accumulated OCI | (379) | 19 | (433) | 79 |
| Interest income (expense) reclassified from accumulated OCI into income | (6) | (5) | (11) | (11) |
| Foreign exchange contracts: | | | | |
| Gain (Loss) recognized in accumulated OCI | (3) | - | (16) | - |
| Other income (expense) reclassified from accumulated OCI into income | - | - | - | - |
| Non-designated Hedging Instruments | Three months ended June 30, 2010 | Three months ended June 30, 2009 | Six months ended June 30, 2010 | Six months ended June 30, 2009 |
| Foreign exchange contracts Other income (expense) | \$ - | \$ 8 | \$ - | \$ (2) |

The balance of the unrealized derivative gain (loss) in accumulated OCI was \$(354) at June 30, 2010 and \$142 at December 31, 2009.

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

NOTE 7. ACQUISITIONS, DISPOSITIONS, AND OTHER ADJUSTMENTS

Acquisitions

Wireless Properties Transaction In May 2009, we announced a definitive agreement to acquire certain wireless properties, including Federal Communications Commission (FCC) licenses and network assets, from Verizon Wireless. On June 22, 2010, we acquired these assets for \$2,372 in cash and increased goodwill by \$972. The assets primarily represent former Alltel Wireless assets and serve approximately 1.6 million subscribers in 79 service areas across 18 states. The preliminary fair value of the acquired net assets of \$1,400 included \$364 of property plant and equipment, \$776 of FCC licenses, and \$194 of customer lists and other intangible assets.

Dispositions

Sale of Sterling Operations In May 2010, we announced a definitive agreement to sell our Sterling subsidiary to International Business Machines Corporation (IBM), an unrelated party, for \$1,400 in cash. Sterling provides business applications and integration solutions to approximately 18,000 customers worldwide. The sale is subject to regulatory approvals and the satisfaction of customary closing conditions. We also entered into a transition services agreement with IBM related to short-term support of Sterling's operations after the sale, and an enterprise license agreement, under which we would purchase software from Sterling.

We are treating Sterling as a discontinued operation as of May 24, 2010, the measurement date, as we have determined that the cash inflows under the transition services agreement and our cash outflows under the enterprise license agreement will not constitute significant continuing involvement with Sterling's operations after the sale. As of the measurement date, we have applied held-for-sale treatment to Sterling's assets and liabilities, as we believe that the sale is probable and anticipate that it will occur by September 30, 2010. Accordingly, we have reclassified Sterling's operating results, for all historical periods, to Net income from discontinued operations in the accompanying consolidated statements of income. We have included Sterling's assets in Other current assets—and the related liabilities in Accounts payable and accrued liabilities—in our consolidated balance sheets as of June 30, 2010, and December 31, 2009. While we committed to sell Sterling in 2010, we have elected to classify Sterling's assets and liabilities as of December 31, 2009, in the same manner as those as of the measurement date for comparability. Sterling's assets and liabilities included the following as of the indicated periods:

| | June 30, 2010 | December 31, 2009 |
|--|-----------------|----------------------|
| Assets held for sale: | | |
| Current assets | \$ 278 | \$ 333 |
| Property, plant and equipment | 36 | 40 |
| Goodwill and other intangible assets | 649 | 672 |
| Other assets | 39 | 47 |
| Total assets | \$ 1,002 | \$ 1,092 |
| Liabilities related to assets held for sale: | | |
| Current liabilities | \$ 294 | \$ 365 |

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| | | |
|-------------------|--------|--------|
| Other liabilities | 122 | 126 |
| Total liabilities | \$ 416 | \$ 491 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

The following table includes Sterling's operating results, which we historically included in our Other segment, for the indicated periods:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|-----------------------------|--------|---------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Operating revenues | \$ 136 | \$ 132 | \$ 268 | \$ 259 |
| Operating expenses | 127 | 126 | 255 | 256 |
| Operating income | 9 | 6 | 13 | 3 |
| Income (loss) before income taxes | 8 | 4 | 10 | (2) |
| Income taxes (benefit) | 12 | 1 | 13 | (1) |
| Income (loss) from discontinued operations | (4) | 3 | (3) | (1) |

We anticipate that we will record a pre-tax gain of \$800 in conjunction with the disposal of Sterling, which we will include as a component of our Income from discontinued operations in the accompanying consolidated statements of income upon completion of the sale.

Centennial We entered into definitive agreements to sell eight Centennial Communications Corp. (Centennial) service areas in Louisiana and Mississippi as a condition to our acquisition of Centennial in November 2009. As of June 30, 2010, the fair value of the assets subject to the Centennial sales, net of related liabilities, was \$282. On July 26, 2010, the sales received clearance from the U.S. Department of Justice but remained subject to approval from the FCC.

Other Adjustments

Centennial As of June 30, 2010, the preliminary fair value measurement of Centennial's net assets acquired included \$1,389 of goodwill, \$655 of FCC licenses, and \$449 of customer lists and other intangible assets. During the six months ended June 30, 2010, we recorded \$226 of Centennial acquisition accounting adjustments, which included a \$111 decrease of accounts payable and accrued liabilities, \$42 increase of property, plant and equipment, \$45 reduction of deferred tax liabilities, an additional \$8 allocation to FCC licenses, and \$20 in other working capital adjustments. These adjustments were all offset to goodwill.

Equity Method Investments

América Móvil Transactions On January 13, 2010, América Móvil, S.A. de C.V. (América Móvil) announced that its Board of Directors authorized a tender offer for 100% of the equity of Carso Global Telecom, S.A.B. de C.V. (CGT), a holding company that owned 59.4% of Telefonos de Mexico, S.A. de C.V., and 60.7% of Telmex Internacional, S.A.B. de C.V. (Telmex Internacional), in exchange for América Móvil L Shares; and an offer for Telmex Internacional shares not owned by CGT, for cash or América Móvil L shares, at the election of the shareholders. On June 11, 2010, we tendered all of our shares in Telmex Internacional for América Móvil L shares at the offered exchange rate of 0.373, which resulted in a pre-tax gain of \$647, or \$0.07 per diluted share after tax, for the three and six months ended June 30, 2010. The exchange was accounted for at fair value, and the América Móvil L shares were recorded at \$1,586. In addition, we paid \$202 to purchase additional shares of América Móvil L stock to restore our ownership percentage in América Móvil to the level that existed before the exchange. Our investment in América Móvil was \$3,450 at June 30, 2010.

NOTE 8. SUBSEQUENT EVENTS

In July 2010, we issued \$2,250 of 2.50% global notes due 2015 for proceeds of approximately \$2,235.

In August 2010, we announced a private offer to exchange any and all of the outstanding 8.750% senior notes of New Cingular Wireless Services, Inc. due 2031 and, subject to pro-ration, the outstanding 8.00% senior notes of AT&T Corp. due 2031, for a new series of AT&T Inc. notes due 2040 and cash. The offer is subject to conditions, including that we receive a minimum principal amount of \$500 in the exchange.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Dollars in millions except per share amounts

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 and wireline telecommunications services and equipment as well as advertising 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, 2009. 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 2010 and 2009 are summarized as follows:

| | Second Quarter | | | Six-Month Period | | |
|---|----------------|-----------|----------------|------------------|-----------|----------------|
| | 2010 | 2009 | Percent Change | 2010 | 2009 | Percent Change |
| Operating Revenues | \$ 30,808 | \$ 30,614 | 0.6 % | \$ 61,338 | \$ 61,071 | 0.4 % |
| Operating expenses | | | | | | |
| Cost of services and sales | 12,381 | 12,557 | (1.4) | 24,716 | 24,758 | (0.2) |
| Selling, general and administrative | 7,475 | 7,682 | (2.7) | 14,863 | 15,340 | (3.1) |
| Depreciation and amortization | 4,838 | 4,875 | (0.8) | 9,638 | 9,733 | (1.0) |
| Total Operating Expenses | 24,694 | 25,114 | (1.7) | 49,217 | 49,831 | (1.2) |
| Operating income | 6,114 | 5,500 | 11.2 | 12,121 | 11,240 | 7.8 |
| Income from continuing operations before income taxes | 6,278 | 4,885 | 28.5 | 11,714 | 9,901 | 18.3 |
| Income from continuing operations | 4,105 | 3,273 | 25.4 | 6,666 | 6,478 | 2.9 |
| Net Income | | | | | | |
| Attributable to AT&T | \$ 4,023 | \$ 3,198 | 25.8 % | \$ 6,498 | \$ 6,324 | 2.8 % |

Overview

Operating income Our operating income increased \$614, or 11.2%, in the second quarter and \$881, or 7.8%, for the first six months of 2010. The increase for the quarter and the six months was primarily due to the continued growth in wireless service revenue, driven mostly by our subscriber growth, along with an increase in wireline data revenue resulting from our growth in Internet Protocol (IP) data revenue. These increases were partially offset by continuing

declines in voice and directory advertising print revenues. Operating income also increased in part due to a decrease in operating expenses, driven by decreases in pension and other postemployment benefits (OPEB) and other employee-related expense. These factors were the primary causes of our operating income margin increasing from 18.0% to 19.8% in the second quarter and from 18.4% to 19.8% for the first six months of 2010, as compared to the same periods last year.

Operating revenues Our operating revenues increased \$194, or 0.6%, in the second quarter and \$267, or 0.4%, for the first six months of 2010. This increase was primarily due to the continued growth in wireless service revenue, driven mostly by our increase in average subscribers and wireless data revenue, along with an increase in wireline data revenue largely due to IP data growth, driven by AT&T U-verseSM subscriber growth. These increases were partially offset by the continuing decline in voice revenues due to decreasing access lines and a decline in directory revenue driven by lower print revenue.

The declines in our voice and advertising revenues reflect continuing economic pressures on our customers as well as increasing competition. Total switched access lines decreased 11.1%. 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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Cost of services and sales expenses decreased \$176, or 1.4%, in the second quarter and \$42, or 0.2%, for the first six months of 2010. The decrease for the quarter was primarily due to lower equipment costs, and lower pension/OPEB expenses and other employee-related costs along with lower traffic compensation. These decreases were partially offset by higher Universal Service Fund (USF), interconnect and network system costs. The decrease for the six months was primarily due to lower pension/OPEB expenses and other employee-related costs, along with lower traffic compensation, partially offset by higher USF costs.

Selling, general and administrative expenses decreased \$207, or 2.7%, in the second quarter and \$477, or 3.1%, for the first six months of 2010. The decrease for the quarter and the six months was primarily due to lower pension/OPEB expenses and other employee-related costs, and lower bad debt expense along with lower indirect commissions expenses, partially offset by increases in various support expenses.

Depreciation and amortization expense decreased \$37, or 0.8%, in the second quarter and \$95, or 1.0%, for the first six months of 2010. The decrease was due to lower amortization of intangibles related to customer lists associated with acquisitions, partially offset by increased depreciation associated with ongoing capital spending for network upgrades and expansion.

Interest expense decreased \$122, or 13.9%, in the second quarter and \$203, or 11.8%, for the first six months of 2010. The declines in interest expense for the quarter and the six months were primarily due to a decrease in our average debt balances, along with a decrease in our weighted average interest rate.

Equity in net income of affiliates decreased \$36, or 15.6%, in the second quarter and increased \$44, or 12.0%, for the first six months of 2010. The second quarter decrease was primarily due to decreased results at América Móvil, S.A. de C.V. (América Móvil) and Telefonos de Mexico, S.A. de C.V. (Telmex). The year to date increase was primarily due to increased first quarter operating results at América Móvil.

Other income (expense) – net We had other income of \$723 in the second quarter and \$700 for the first six months of 2010, compared to other income of \$30 in the second quarter and \$15 for the first six months of 2009. Results for the second quarter of 2010 included a \$647 gain on the exchange of Telmex Internacional, S.A.B. de C.V. (Telmex Internacional) shares for América Móvil shares (See Note 7), a \$41 gain on sale of investments, and \$28 in interest, dividend and leveraged lease income. Results in the second quarter of 2009 primarily included \$50 in interest and lease income partially offset by \$14 of foreign exchange losses.

Results for the first six months of 2010 included a \$647 gain on the exchange of Telmex Internacional shares for América Móvil shares, and a \$50 gain on sale of investments. Results for the first six months of 2009 included \$42 of gains on sales of securities and a professional services business, and dividend, interest, and leveraged lease income of \$77 partially offset by \$102 related to Rabbi Trust asset impairment.

Income taxes increased \$561, or 34.8%, in the second quarter and \$1,625, or 47.5%, for the first six months of 2010. The increase in income taxes for the second quarter was due to higher income before income taxes and to favorable adjustments booked in the second quarter of 2009 related to completion of the examination phase of IRS audits. The increase in income taxes for the first six months primarily resulted from a change in the tax treatment of the Medicare Part D subsidy included in the Patient Protection and Affordable Care Act and the Health Care and Education

Reconciliation Act of 2010, which we recorded as a charge of \$995, along with higher income before income taxes. Our effective tax rates were 34.6% in the second quarter of 2010, compared to 33.0% in the second quarter of 2009, and 43.1% for the first six months of 2010, compared to 34.6% for the first six months of 2009. The net increase in our effective tax rate for the quarter was due primarily to the favorable adjustments related to the completion of the examination phase of the IRS audits during second quarter 2009, while the net increase in the effective tax rate for the six months was due to the enactment of the aforementioned health care legislation.

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Selected Financial and Operating Data

| | June 30, | |
|--|----------|---------|
| | 2010 | 2009 |
| Wireless customers (000) | 90,130 | 79,600 |
| Postpaid wireless customers (000) ⁷ | 66,970 | 61,647 |
| Prepaid wireless customers (000) ⁷ | 5,881 | 5,558 |
| Reseller wireless customers (000) ⁷ | 10,597 | 9,286 |
| Connected devices (000) ⁷ | 6,682 | 3,109 |
| Consumer revenue connections (000) ^{1,2} | 44,262 | 46,288 |
| Network access lines in service (000) ^{2,9} | 46,558 | 52,379 |
| Broadband connections (000) ^{2,3,7} | 17,439 | 16,945 |
| Video connections (000) ⁴ | 4,558 | 3,787 |
| Debt ratio ^{5,7,8} | 40.3 % | 43.7 % |
| Ratio of earnings to fixed charges ⁶ | 5.59 | 4.59 |
| Number of AT&T employees | 272,450 | 288,660 |

Consumer revenue connections includes retail access lines, U-verse voice over IP connections, broadband and video.

²Represents services by AT&T's local exchange companies (ILECs) and affiliates.

³Broadband connections include DSL, U-verse High Speed Internet, satellite broadband and 3G LaptopConnect cards.

⁴Video connections include customers that have satellite service under our agency arrangements and U-verse video connections (of 2,505 in 2010 and 1,577 in 2009).

⁵See our "Liquidity and Capital Resources" section for discussion.

⁶See Exhibit 12.

⁷Prior-year amounts restated to conform to current-period reporting methodology.

⁸Debt ratios are calculated by dividing total debt (debt maturing within one year plus long-term debt) by total capital (total debt plus total stockholder's equity) and does not consider cash on hand available to pay down debt. Cash on hand was \$1,377 as of June 30, 2010 and \$3,741 as of December 31, 2009.

⁹At June 30, 2010, total switched access lines were 46,558, retail business switched access lines totaled 19,465 and wholesale and coin switched access lines totaled 2,641. These include 1,725 retail business and 102 wholesale lines that are used solely by AT&T or our subsidiaries.

Segment Results

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. 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 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-verseSM TV, high-speed broadband and voice services (U-verse) and managed networking to business customers. Additionally, we receive commissions on sales of satellite television services offered through our agency arrangements.

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.

The Other segment includes results from customer information services and all corporate and other operations. This segment includes our portion of the results from our international equity investments. Also included in the Other segment are impacts of corporate-wide decisions for which the individual operating segments are not being evaluated. In May 2010, we announced the sale of Sterling Commerce Inc. (Sterling). The Other segment results for all periods shown have been restated to exclude the results of Sterling, which are now reflected in discontinued operations (See Note 7).

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Historically, the intersegment activity had been reported as revenue in the billing segment and operating expense in the purchasing segment. Upon consolidation, the intersegment revenue and expense were eliminated with the consolidated results reflecting the cash operating and depreciation expense of providing the intersegment service. As part of AT&T's ongoing initiatives to manage its business from an external customer perspective, we no longer report intersegment revenue and report the cash operating and depreciation expense related to intersegment activity in the purchasing segment which provided services to the external customer. While this change did not impact AT&T's total consolidated results, the impact to each operating segment varied. In particular, the Wireless segment, as a purchaser of network, IT and other services from the Wireline segment, experienced a reduction in cash operating expense partially offset by increased depreciation expense with the net result being increased operating margins. This change was effective with the reporting of operating results for the quarter ended March 31, 2010. We have restated prior-period segment information to conform to the current period's presentation.

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 | | |
|---|-----------------|-----------------|----------------|------------------|-----------------|----------------|
| | 2010 | 2009 | Percent Change | 2010 | 2009 | Percent Change |
| Segment operating revenues | | | | | | |
| Service | \$ 13,186 | \$ 11,960 | 10.3 % | \$ 26,036 | \$ 23,606 | 10.3 % |
| Equipment | 1,056 | 1,262 | (16.3) | 2,103 | 2,454 | (14.3) |
| Total Segment Operating Revenues | 14,242 | 13,222 | 7.7 | 28,139 | 26,060 | 8.0 |
| Segment operating expenses | | | | | | |
| Operations and support | 8,562 | 8,428 | 1.6 | 16,745 | 16,314 | 2.6 |
| Depreciation and amortization | 1,578 | 1,504 | 4.9 | 3,136 | 3,003 | 4.4 |
| Total Segment Operating Expenses | 10,140 | 9,932 | 2.1 | 19,881 | 19,317 | 2.9 |
| Segment Operating Income | 4,102 | 3,290 | 24.7 | 8,258 | 6,743 | 22.5 |
| Equity in Net Income of Affiliates | | | | | | |
| | 7 | - | - | 20 | - | - |
| Segment Income | \$ 4,109 | \$ 3,290 | 24.9 % | \$ 8,278 | \$ 6,743 | 22.8 % |

Wireless Properties Transactions

In May 2009, we announced a definitive agreement to acquire certain wireless properties, including Federal Communications Commission (FCC) licenses and network assets from Verizon Wireless. On June 22, 2010, we

acquired these assets for \$2,372 in cash and increased goodwill by \$972. The assets primarily represent former Alltel Wireless assets and serve approximately 1.6 million subscribers in 79 service areas across 18 states. We included these customers in our total customer base as of June 30, 2010, but did not include them in our net customer additions for the second quarter of 2010. The preliminary fair value of the acquired net assets of \$1,400 included \$364 of property, plant and equipment, \$776 of FCC licenses, and \$194 of customer lists and other intangible assets.

Since the properties we acquired use a different network technology than our Global System for Mobile Communication (GSM) technology, we expect to incur additional costs to convert that network and subscriber handsets to our GSM technology.

We have entered into definitive agreements to sell eight Centennial Communications, Corp. (Centennial) service areas in Louisiana and Mississippi as a condition to our acquisition of Centennial in November 2009. As of June 30, 2010, the fair value of the assets subject to the Centennial sales, net of related liabilities, was \$282. On July 26, 2010, the sales received clearance from the U.S. Department of Justice but remained subject to approval from the FCC.

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Wireless Metrics

Additions As of June 30, 2010, we served 90.1 million wireless customers. Net organic customer additions (net additions) for the second quarter of 2010, totaled 1.6 million, compared to 1.4 million for the same period in 2009, and net additions for the six months ended June 30, 2010, totaled 3.4 million, compared to 2.6 million for the same period in 2009. Net additions for the second quarter of 2010 included an 896,000 net increase in connected devices subscribers and a 300,000 net increase in prepaid subscribers. Net additions for the six months ended June 30, 2010, included a 1.9 million net increase in connected devices subscribers. Net postpaid additions of 496,000 for the second quarter of 2010 were down 56.0%, compared to the same period in 2009, and down 50.2% for the six months ended June 30, 2010, compared to the same period in 2009, reflecting slowing growth in the industry subscriber base and lower postpaid churn throughout the industry. We expect that net postpaid additions during 2010 will continue to decrease from prior-year levels, and revenue growth will continue to shift toward data revenues with increasing penetration rates for integrated devices and additional sales of connected devices. In 2010, we have continued to see an increase in gross and net additions related to the sale of smartphones and connected devices, such as eReaders and alarm monitoring devices, and we expect continued growth in these product areas.

Average service revenue per user (ARPU) in the second quarter of 2010 and the six months ended June 30, 2010, declined 1.1% and 0.8% compared to the same periods in 2009, reflecting strong growth in connected devices subscribers, which have a lower ARPU compared to ARPU generated by our other customers. Data service ARPU increased 14.0% and 15.5% in the second quarter of 2010 and six months ended June 30, 2010, compared to the same periods in 2009. We expect continued revenue growth from data services, as more customers purchase advanced integrated devices and connected devices, such as eReaders, alarm monitoring, and mobile navigation devices, and as we continue to expand our network. Voice and other service ARPU declined 7.3% and 7.2% in the second quarter of 2010 and the six months ended June 30, 2010, compared to the same periods in 2009.

ARPU from postpaid customers increased 3.4% in the second quarter of 2010 and 3.7% in the six months ended June 30, 2010, compared to the same periods in 2009, reflecting usage of more advanced integrated devices by these customers, evidenced by an 18.6% increase in postpaid data services ARPU in the second quarter of 2010 and a 20.1% increase in postpaid data services ARPU in the six months ended June 30, 2010. Approximately half of our postpaid customers now use integrated devices. The growth in postpaid data services ARPU in the second quarter of 2010 and six months ended June 30, 2010, was partially offset by a 2.9% decline in postpaid voice and other service ARPU for the same periods in 2010. Postpaid voice and other service ARPU declined due to lower access charges, roaming revenues, and long-distance usage. Increases in our family plans (Family Talk® plans), connected devices, and reseller customer base, which have lower ARPU than traditional postpaid customers, have also contributed to these declines. We expect continued pressure on voice and other service ARPU.

Churn The effective management of customer churn (churn rate) is critical to our ability to maximize revenue growth and to maintain and improve margins. Churn rate is calculated by dividing the aggregate number of wireless customers who cancel service during a period by the total number of wireless customers at the beginning of that period. The churn rate for a quarterly period is equal to the average churn rate for each month of that period. Ongoing improvement in our total and postpaid churn rate—now at our lowest recorded levels—contributed to our net additions in the second quarter of 2010 and the six months ended June 30, 2010. Our churn rate was 1.29% for the second quarter

of 2010 and six months ended June 30, 2010, down from 1.48% and 1.52% for the same periods in 2009. The postpaid churn rate was 1.01% for the second quarter of 2010, down from 1.07% for the same period in 2009, and it decreased to 1.04% for the six months ended June 30, 2010, compared to 1.11% for the same period in 2009. These churn rate declines reflect network enhancements and broader coverage, more affordable rate plans and exclusive devices, continued growth in Family Talk® plans, and free mobile-to-mobile calling among our wireless customers.

Wireless Customer Relationships

The wireless industry continues to mature. Accordingly, we believe that future wireless growth will increasingly depend on our ability to offer innovative services and devices. To attract and retain customers, we offer a wide variety of service plans in addition to offering a broad handset line. Our post-paid customers typically sign a two-year contract, which includes discounted handsets and early termination fees (i.e., compensation to us for our investment in the customer). We also offer data plans at different price levels, beginning as low as \$15 per month, to attract a wide variety of customers and differentiate us from our competitors. Many of our customers are on Family Talk® plans or business plans, which provide for service on multiple handsets at discounted rates, and such subscribers tend to have higher retention and lower churn rates. As of June 30, 2010, more than 80 percent of our postpaid subscribers are on Family Talk® and/or business plans. Such offerings are intended to encourage existing customers to upgrade their current services and/or add connected devices, attract customers from other providers, and minimize customer churn. In fact, for the first half of 2010, over 60 percent of our smartphone handsets were purchased by existing AT&T customers.

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We offer a large variety of handsets, including at least 18 smartphones (including Apple iPhones, our most popular models) with advanced operating systems from at least 7 manufacturers. As technology evolves, rapid changes are occurring in the handset and device industry, with the continual introduction of new models or significant revisions of existing models. We believe offering a wide variety of handsets reduces dependence on any single handset as these products evolve. In addition, offering a number of attractive handsets on an exclusive basis distinguishes us from our competitors. As these exclusivity arrangements end, we expect to continue to offer such handsets (based on historical industry practice), and we believe our service plan offerings will help to retain our customers by providing incentives not to move to a new carrier. As noted above, more than 80 percent of our postpaid subscribers are on Family Talk® Plans and business plans that would involve moving the whole group to a new carrier. Moreover, the vast majority of our postpaid subscribers (including Family Talk® Plan users) are allowed to accumulate unused minutes (known as rollover minutes), a feature that is currently not offered by other major post-paid carriers in the United States, and users would lose these minutes if they switched carriers. As is common in the industry, most of our phones are designed to work only with our wireless technology, requiring customers who desire to move to a new carrier with a different technology to purchase a new device. In addition, many of our handsets would not work or would lose some functionality if they were used on another carrier's network (even a carrier using GSM technology), requiring the customer to acquire another handset. Although exclusivity arrangements are important to us, such arrangements may not provide a competitive advantage over time, as the industry continues to introduce new devices and services. Also, while the expiration of any of our current exclusivity arrangements could increase churn and reduce postpaid customer additions, we do not expect any such terminations to have a material negative impact on our Wireless segment income, consolidated operating margin or our cash from operations.

Wireless Operating Results

Our Wireless segment operating income margin was 28.8% in the second quarter of 2010, compared to 24.9% for the same period in 2009, and increased to 29.3% for the six months ended June 30, 2010, compared to 25.9% for the same period in 2009. Higher margins for these periods were primarily due to operating revenue growth that continued to exceed operating expense growth. Wireless margins improved in the second quarter of 2010 despite record Apple iPhone activations.

Service revenues are comprised of local voice and data services, roaming, long-distance and other revenue. Service revenues increased \$1,226, or 10.3%, in the second quarter of 2010, compared to the same period in 2009, and increased \$2,430, or 10.3%, in the six months ended June 30, 2010, compared to the same period in 2009. The increases for these periods consisted of the following:

- Data service revenue increased \$936, or 27.2%, in the second quarter of 2010, compared to the same period in 2009, and increased \$1,883, or 28.4%, in the six months ended June 30, 2010, compared to the same period in 2009. The increases were primarily due to the increased number of subscribers and heavier text and multimedia messaging by subscribers using integrated devices and other data-centric connected devices, such as eReaders and mobile navigation devices. Data service revenues represented 33.2% of our Wireless segment service revenues in the second quarter of 2010, an increase from 28.8% for the same period in 2009.
- Voice and other service revenue increased \$290, or 3.4%, in the second quarter of 2010 and \$547, or 3.2%, in the six months ended June 30, 2010, compared to the same periods in 2009. The increases were due to an 11.8% increase and an 11.3% increase in the average number of wireless customers in the second quarter of 2010 and the six months ended June 30, 2010, compared to the same periods in 2009, partially offset by lower ARPU for these services.

Equipment revenues decreased \$206, or 16.3%, in the second quarter of 2010, compared to the same period in 2009, and decreased \$351, or 14.3%, in the six months ended June 30, 2010, compared to the same period in 2009. The decrease was due to lower traditional handset sales and increased sales of lower priced integrated devices.

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Operations and support expenses increased \$134, or 1.6%, in the second quarter of 2010, compared to the same period in 2009. The second quarter increase was primarily due to the following:

- Interconnect, USF, and network system cost increases of \$333 due to higher network traffic, revenue growth, and a USF rate increase;
- Information technology and other administrative expense increases of \$211; and
- Selling expense increases (other than commissions) of \$51, primarily due to increased advertising in response to competitive pressures.

These increases were partially offset by the following:

- Equipment cost net decreases of \$157;
- Bad debt expense decrease of \$103;
- Commission expense and reseller services cost decreases of \$93; and
- Customer service, long distance, and incollect roaming cost decreases of \$78.

Operations and support expenses increased \$431, or 2.6%, in the six months ended June 30, 2010. The year to date increase was primarily due to the following:

- Interconnect, USF, and network system cost increases of \$514 due to higher network traffic, revenue growth, and a USF rate increase;
- Information technology and other administrative expense increases of \$261; and
- Selling expense increases (other than commissions) of \$157, primarily due to increased advertising in response to competitive pressures.

These increases were partially offset by the following:

- Commission expense and reseller services cost decreases of \$211;
- Bad debt expense decrease of \$152; and
- Customer service, long distance, and incollect roaming cost decreases of \$151.

The decreases in the 2010 periods were due in part to lower net postpaid additions in the second quarter of 2010 and six months ended June 30, 2010, compared to the same periods in 2009.

Depreciation and amortization expenses increased \$74, or 4.9%, in the second quarter and \$133, or 4.4%, for the first six months of 2010. Depreciation expense increased \$160, or 14.7%, in the second quarter and \$311, or 14.5%, in the first six months ended June 30, 2010, primarily due to increased capital spending for network upgrades and expansion and depreciation for assets acquired with the Centennial acquisition, partially offset by certain network assets becoming fully depreciated.

Amortization expense decreased \$86, or 20.7%, in the second quarter and \$178, or 20.6%, for the first six months, primarily due to lower amortization of intangibles for customer lists related to acquisitions, partially offset by an increase in customer lists amortization related to the Centennial acquisition.

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Wireless Supplementary Operating and Financial Data
Second Quarter

| | Second Quarter | | | Six-Month Period | | |
|---|----------------|--------|----------------|------------------|--------|----------------|
| | 2010 | 2009 | Percent Change | 2010 | 2009 | Percent Change |
| Wireless Customers (000) | | | | 90,130 | 79,600 | 13.2 % |
| Net Customer Additions (000) | 1,562 | 1,368 | 14.2 % | 3,419 | 2,591 | 32.0 % |
| Total Churn | 1.29 % | 1.48 % | (19) BP | 1.29 % | 1.52 % | (23) BP |
| Postpaid Customers (000) | | | | 66,970 | 61,647 | 8.6 % |
| Net Postpaid Customer Additions (000) | 496 | 1,128 | (56.0) % | 1,008 | 2,025 | (50.2) % |
| Postpaid Churn | 1.01 % | 1.07 % | (6) BP | 1.04 % | 1.11 % | (7) BP |
| Prepaid Customers (000) | | | | 5,881 | 5,558 | 5.8 % |
| Net Prepaid Customer Additions (000) | 300 | (412) | - | 324 | (567) | - |
| Reseller Customers (000) | | | | 10,597 | 9,286 | 14.1 % |
| Net Reseller Customer Additions (000) | (130) | 348 | - | 139 | 685 | - |
| Connected Device Customers (000) | | | | 6,682 | 3,109 | - |
| Net Connected Device Customer Additions (000) | 896 | 304 | - | 1,948 | 448 | - |

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Wireline
Segment Results

| | Second Quarter | | | Six-Month Period | | |
|------------------------------------|----------------|---------|----------------|------------------|----------|----------------|
| | 2010 | 2009 | Percent Change | 2010 | 2009 | Percent Change |
| Segment operating revenues | | | | | | |
| Voice | \$7,219 | \$8,255 | (12.5)% | \$14,698 | \$16,758 | (12.3)% |
| Data | 6,848 | 6,323 | 8.3 | 13,479 | 12,605 | 6.9 |
| Other | 1,329 | 1,411 | (5.8) | 2,640 | 2,788 | (5.3) |
| Total Segment Operating Revenues | 15,396 | 15,989 | (3.7) | 30,817 | 32,151 | (4.1) |
| Segment operating expenses | | | | | | |
| Operations and support | 10,389 | 10,924 | (4.9) | 21,006 | 21,856 | (3.9) |
| Depreciation and amortization | 3,123 | 3,194 | (2.2) | 6,219 | 6,368 | (2.3) |
| Total Segment Operating Expenses | 13,512 | 14,118 | (4.3) | 27,225 | 28,224 | (3.5) |
| Segment Operating Income | 1,884 | 1,871 | 0.7 | 3,592 | 3,927 | (8.5) |
| Equity in Net Income of Affiliates | - | 4 | - | 5 | 7 | (28.6) |
| Segment Income | \$1,884 | \$1,875 | 0.5% | \$3,597 | \$3,934 | (8.6)% |

Operating Income and Margin Trends

Our wireline segment operating income increased \$13, or 0.7%, in the second quarter of 2010 and decreased \$335, or 8.5%, for the first six months of 2010. For the second quarter of 2010 and 2009, our wireline segment operating income margin increased from 11.7% to 12.2%, and for the first six months decreased from 12.2% in 2009 to 11.7% in 2010. Our operating income continued to be pressured by access line declines as customers either reduced usage or disconnected traditional landline services and switched to alternative technologies, such as wireless and VoIP. Our strategy is to offset these line losses by increasing non-access-line-related revenues from customer connections for data, video, and voice. Additionally, we have the opportunity to increase Wireless segment revenues if customers choose AT&T Mobility as an alternative provider. For the second quarter, continued growth in data revenue driven by U-verse growth along with operating expense reductions were both offset by continued voice revenue declines. Decreases in wireline operating expenses reflect reduced pension/OPEB and other employee-related costs and impacts of continuing cost initiatives.

Operating Results

Voice revenues decreased \$1,036, or 12.5%, in the second quarter and \$2,060, or 12.3%, for the first six months of 2010 primarily due to continuing economic pressures and declining demand for traditional voice services by our consumer and business customers. Included in voice revenues are revenues from local voice, long-distance (including international) and local wholesale services. Voice revenues do not include VoIP revenues, which are included in data revenues.

- Local voice revenues decreased \$595, or 11.8%, in the second quarter and \$1,202, or 11.7%, for the first six months of 2010. The decrease was driven primarily by an 11.1% decline in total switched access lines and a decrease in average local voice revenue per user. We expect our local voice revenue to continue to be negatively affected by

increased competition from alternative technologies and the disconnection of additional lines.

- Long-distance revenues decreased \$401, or 13.9%, in the second quarter and \$774, or 13.2%, for the first six months of 2010. Lower demand for long-distance service from global businesses and consumer customers decreased revenues \$320 in the second quarter and \$601 for the first six months of 2010, and declines in the number of our national mass-market customers decreased revenues \$85 in the second quarter and \$179 for the first six months of 2010.

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Data revenues increased \$525, or 8.3%, in the second quarter and \$874, or 6.9%, for the first six months of 2010. Data revenues accounted for approximately 44% of wireline operating revenues in 2010 and 40% in 2009. Data revenues include transport, IP and packet-switched data services.

- IP data revenues increased \$647, or 20.2%, in the second quarter and \$1,199, or 19.2%, for the first six months of 2010 primarily driven by AT&T U-verse expansion and growth in IP-based strategic business services which include virtual private networks (VPN), and application services. U-verse video increased \$331 in the second quarter and \$628 for the first six months of 2010, and strategic business service revenues increased \$158 in the second quarter and \$301 for the first six months of 2010. Broadband high speed Internet access increased IP data revenues \$105 in the second quarter and \$196 for the first six months of 2010. The increase in IP data revenues reflects continued growth in the customer base and migration from other traditional circuit-based services.
- Packet switched data services revenue, which include frame relay and asynchronous transfer mode services, decreased \$104, or 20.2%, in the second quarter and \$226, or 21.2%, for the first six months of 2010. This decrease is primarily due to lower demand as customers continue to shift to IP-based technology such as VPN, DSL and managed Internet services. We expect these traditional services to continue to decline as a percentage of our overall data revenues.

Other operating revenues decreased \$82, or 5.8%, in the second quarter and \$148, or 5.3%, for the first six months of 2010. Integration services and customer premises equipment, government-related services and outsourcing account for more than 60% of total other revenue for all periods. Revenue from equipment sales and related network integration decreased by \$70 in the second quarter and \$122 for the first six months of 2010 primarily due to economic pressure on business customers.

Operations and support decreased \$535, or 4.9%, in the second quarter and decreased \$850, or 3.9%, for the first six months of 2010. Operation and support expenses consist of costs incurred to provide our products and services, including costs of operating and maintaining our networks and personnel costs, such as salary, wage and bonus accruals. Costs in this category include our repair technicians and repair services, certain network planning and engineering expenses, information technology and property taxes. Operations and support expenses also 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 costs, net of amounts capitalized as part of construction labor, are also included to the extent that they are associated with these employees.

The decrease was primarily due to lower Pension/OPEB and other employee-related expense of \$390 in the second quarter and \$730 in the first six months, lower traffic compensation of \$89 in the second quarter and \$104 in the first six months, lower contract services of \$42 in the second quarter and \$173 in the first six months, and lower uncollectibles of \$43 in the second quarter and \$156 in the first six months.

Partially offsetting these decreases were increased USF expenses of \$84 in the second quarter and \$237 in the first six months due to rate increases.

Depreciation and amortization expenses decreased \$71, or 2.2%, in the second quarter and \$149, or 2.3%, for the first six months. The second quarter and year to date decrease was primarily related to lower amortization of intangibles for customer lists associated with acquisitions.

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Supplemental Information

Telephone, Wired Broadband and Video Connections Summary

Our switched access lines and other services provided by our local exchange telephone subsidiaries at June 30, 2010 and 2009 are shown below and trends are addressed throughout this segment discussion.

(in 000s)

| | June 30, 2010 | June 30, 2009 | Percent Change |
|--|------------------|------------------|-------------------|
| Switched Access Lines ¹ | | | |
| Retail Consumer | 24,452 | 28,477 | (14.1)% |
| Retail Business ² | 19,465 | 21,078 | (7.7) |
| Retail Subtotal ² | 43,917 | 49,555 | (11.4) |
| Percent of total switched access lines | 94.3 % | 94.6 % | |
| Wholesale Subtotal ² | 2,570 | 2,726 | (5.7) |
| Percent of total switched access lines | 5.5 % | 5.2 % | |
| Payphone (Retail and Wholesale) ³ | 71 | 98 | (27.6) |
| Percent of total switched access lines | 0.2 % | 0.2 % | |
| Total Switched Access Lines ⁷ | 46,558 | 52,379 | (11.1)% |
| Total Retail Consumer Voice Connections ⁶ | 25,780 | 29,047 | (11.2)% |
| Total Wired Broadband Connections ⁴ | 15,952 | 15,548 | 2.6 % |
| Satellite service ⁵ | 2,053 | 2,210 | (7.1)% |
| U-verse video | 2,505 | 1,577 | 58.8 |
| Video Connections | 4,558 | 3,787 | 20.4 % |

¹ Represents access lines served by AT&T's ILECs and affiliates.

² Prior-period amounts restated to conform to current-period reporting methodology.

³ Revenue from retail payphone lines is reported in the Other segment. We are in the process of ending our retail payphone operations.

⁴ Total wired broadband connections include DSL, U-verse High Speed Internet and satellite broadband.

⁵ Satellite service includes connections under our agency and resale agreements.

⁶ Includes consumer U-verse Voice over IP connections of 1,328 at June 30, 2010.

⁷ At June 30, 2010, total switched access lines were 46,558, retail business switched access lines totaled 19,465 and wholesale and coin switched access lines totaled 2,641. These include 1,725 retail business and 102 wholesale lines that are used solely by AT&T or our subsidiaries.

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Advertising Solutions
Segment Results

| | Second Quarter | | | Six-Month Period | | |
|----------------------------------|----------------|---------|----------------|------------------|---------|----------------|
| | 2010 | 2009 | Percent Change | 2010 | 2009 | Percent Change |
| Total Segment Operating Revenues | \$1,007 | \$1,211 | (16.8)% | \$2,048 | \$2,460 | (16.7)% |
| Segment operating expenses | | | | | | |
| Operations and support | 673 | 706 | (4.7) | 1,348 | 1,427 | (5.5) |
| Depreciation and amortization | 132 | 166 | (20.5) | 270 | 342 | (21.1) |
| Total Segment Operating Expenses | 805 | 872 | (7.7) | 1,618 | 1,769 | (8.5) |
| Segment Income | \$202 | \$339 | (40.4)% | \$430 | \$691 | (37.8)% |

Operating Results

Our advertising solutions operating income margin was 20.1% in the second quarter of 2010, compared to 28.0% in the second quarter of 2009, and 21.0% for the first six months of 2010, compared to 28.1% for the first six months of 2009.

Operating revenues decreased \$204, or 16.8%, in the second quarter and \$412, or 16.7%, for the first six months of 2010, largely driven by continued declines in print revenue of \$222 in the second quarter and \$456 for the first six months as customers reduced or eliminated print ad purchases due to the slow economy. These decreases were partially offset by increased Internet revenue of \$20 in the second quarter and \$46 for the first six months as some customers shifted from print ads.

Operating expenses decreased \$67, or 7.7%, in the second quarter and \$151, or 8.5%, for the first six months of 2010, largely driven by decreased amortization of \$34 in the second quarter and \$72 for the first six months, resulting from use of an accelerated method of amortization for the customer lists and decreases in print product related expenses of \$38 in the second quarter and \$60 in the first six months.

Other
Segment Results

| | Second Quarter | | | Six-Month Period | | |
|------------------------------------|----------------|-------|----------------|------------------|--------|----------------|
| | 2010 | 2009 | Percent Change | 2010 | 2009 | Percent Change |
| Total Segment Operating Revenues | \$163 | \$192 | (15.1)% | \$334 | \$400 | (16.5)% |
| Total Segment Operating Expenses | 237 | 192 | 23.4 | 493 | 521 | (5.4) |
| Segment Operating Income (Loss) | (74) | - | - | (159) | (121) | (31.4) |
| Equity in Net Income of Affiliates | 188 | 226 | (16.8) | 387 | 360 | 7.5 |

| | | | | | | |
|-----------------------|-------|-------|----------|-------|-------|---------|
| Segment Income (Loss) | \$114 | \$226 | (49.6)% | \$228 | \$239 | (4.6)% |
|-----------------------|-------|-------|----------|-------|-------|---------|

Our Other segment operating results consist primarily of customer information services (primarily operator services and payphone), corporate and other operations. In the second quarter 2010, Sterling was moved to discontinued operations. The other segment results for all periods shown have been restated to exclude the results of Sterling.

Segment operating revenues decreased \$29, or 15.1%, in the second quarter and \$66, or 16.5%, for the first six months of 2010 primarily due to reduced revenues from our operator services.

Segment operating expenses increased \$45, or 23.4%, in the second quarter and decreased \$28, or 5.4%, for the first six months of 2010. The second quarter increase was primarily due to mark-to-market adjustments of benefit plan investments. The year to date change was primarily due to decreased operator services expense.

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Our Other segment also includes our equity investments in international companies, the income from which we report as equity in net income of affiliates. Our earnings from foreign affiliates are sensitive to exchange-rate changes in the value of the respective local currencies. Our foreign investments are recorded using the equity method of accounting and exclude certain adjustments required for local reporting in specific countries. Our equity in net income of affiliates by major investment is listed below:

| | Second Quarter | | Six-Month Period | |
|--|----------------|-------|------------------|-------|
| | 2010 | 2009 | 2010 | 2009 |
| América Móvil | \$138 | \$157 | \$283 | \$258 |
| Telmex | 31 | 49 | 71 | 66 |
| Telmex Internacional | 19 | 20 | 35 | 37 |
| Other | - | - | (2) | (1) |
| Other Segment Equity in Net Income of Affiliates | \$188 | \$226 | \$387 | \$360 |

Equity in net income of affiliates decreased \$38, or 16.8%, in the second quarter and increased \$27, or 7.5%, for the first six months of 2010. The second quarter decrease was primarily due to decreased results at América Móvil and Telmex. The year to date increase was primarily due to increased first quarter operating results at América Móvil. On January 13, 2010, América Móvil announced that its Board of Directors authorized a tender offer for 100% of the equity of Carso Global Telecom, S.A.B. de C.V. (CGT), a holding company that owned 59.4% of Telmex and 60.7% of Telmex Internacional, in exchange for América Móvil L Shares; and an offer for Telmex Internacional shares not owned by CGT, for cash or América Móvil L shares, at the election of the shareholders. On June 11, 2010, we tendered all of our shares in Telmex Internacional for América Móvil L shares at the offered exchange rate of 0.373, which resulted in a pre-tax gain of \$647, or \$0.07 per diluted share after tax, for the three and six months ended June 30, 2010. The exchange was accounted for at fair value, and the América Móvil shares were recorded at \$1,586. In addition, we paid \$202 to purchase additional shares of América Móvil L stock to restore our ownership percentage in América Móvil to the level that existed before the exchange. Our investment in América Móvil was \$3,450 at June 30, 2010.

OTHER BUSINESS MATTERS

U-verse Services We are continuing to expand our deployment of U-verse High Speed Internet and TV services. As of June 30, 2010, we have passed 25 million living units (constructed housing units as well as platted housing lots) and are marketing the services to almost 75 percent of those units. Our deployment strategy is to enter each new area on a limited basis in order to ensure that all operating and back-office systems are functioning successfully and then expand within each as we continue to monitor these systems. Our rate of expansion will be slowed if we cannot obtain all required local building permits in a timely fashion. We also continue to work with our vendors on improving, in a timely manner, the requisite hardware and software technology. Our deployment plans could be delayed if we do not receive required equipment and software on schedule.

We believe that our U-verse TV service is subject to federal oversight as a "video service" under the Federal Communications Act. However, some cable providers and municipalities have claimed that certain IP services should be treated as a traditional cable service and therefore subject to the applicable state and local cable regulation. Certain

municipalities have delayed our request or have refused us permission to use our existing right-of-ways to deploy or activate our U-verse-related services and products, resulting in litigation. Pending negotiations and current or threatened litigation involving municipalities could delay our deployment plans in those areas. Petitions have been filed at the FCC alleging that the manner in which AT&T provisions “public, educational and governmental” (PEG) programming over its U-verse TV service conflicts with federal law, and a lawsuit has been filed in a California state superior court raising similar allegations under California law. If courts having jurisdiction where we have significant deployments of our U-verse services were to decide that federal, state and/or local cable regulation were applicable to our U-verse services, or if the FCC, state agencies or the courts were to rule that AT&T must deliver PEG programming in a manner substantially different from the way it does today or in ways that are inconsistent with AT&T’s current network architecture, it could have a material adverse effect on the cost, timing and extent of our deployment plans.

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Retiree Phone Concession Litigation In May 2005, we were served with a purported class action in U.S. District Court, Western District of Texas (*Stoffels v. SBC Communications Inc.*), in which the plaintiffs, who are retirees of Pacific Bell Telephone Company, Southwestern Bell and Ameritech, contend that the telephone concession provided by the company is, in essence, a “defined benefit plan” within the meaning of the Employee Retirement Income Security Act of 1974, as amended (ERISA). In October 2006, the Court certified two classes. The issue of whether the concession is an ERISA pension plan was tried before the judge in November 2007. In May 2008, the court ruled that the concession was an ERISA pension plan. We asked the court to certify this ruling for interlocutory appeal, and in August 2008, the court denied our request. In May 2009, we filed a motion for reconsideration with the trial court. That motion is pending. We believe that an adverse outcome having a material effect on our financial statements in this case is unlikely, but we will continue to evaluate the potential impact of this suit on our financial results as it progresses.

NSA Litigation Twenty-four lawsuits were filed alleging that we and other telecommunications carriers unlawfully provided assistance to the National Security Agency in connection with intelligence activities that were initiated following the events of September 11, 2001. In the first filed case, *Hepting et al v. AT&T Corp., AT&T Inc. and Does 1-20*, a purported class action filed in U.S. District Court in the Northern District of California, plaintiffs alleged that the defendants disclosed and are currently disclosing to the U.S. Government content and call records concerning communications to which Plaintiffs were a party. Plaintiffs sought damages, a declaratory judgment and injunctive relief for violations of the First and Fourth Amendments to the United States Constitution, the Foreign Intelligence Surveillance Act (FISA), the Electronic Communications Privacy Act and other federal and California statutes. We filed a motion to dismiss the complaint. The United States asserted the “state secrets privilege” and related statutory privileges and also filed a motion asking the court to dismiss the complaint. The Court denied the motions, and we and the United States appealed. In August 2008, the U.S. Court of Appeals for the Ninth Circuit remanded the case to the district court without deciding the issue in light of the passage of the FISA Amendments Act, a provision of which addresses the allegations in these pending lawsuits (immunity provision). The immunity provision requires the pending lawsuits to be dismissed if the Attorney General certifies to the court either that the alleged assistance was undertaken by court order, certification, directive or written request or that the telecom entity did not provide the alleged assistance. In September 2008, the Attorney General filed his certification and asked the district court to dismiss all of the lawsuits pending against the AT&T Inc. telecommunications companies. The court granted the Government's motion to dismiss and entered final judgments in July 2009. In addition, a lawsuit seeking to enjoin the immunity provision's application on grounds that it is unconstitutional was filed. In March 2009, we and the Government filed motions to dismiss this lawsuit. The court granted the motion to dismiss and entered final judgment in July 2009. All cases brought against the AT&T entities have been dismissed. In August 2009, plaintiffs in all cases filed an appeal with the Ninth Circuit Court of Appeals and this appeal remains pending.

Management believes this appeal is without merit and intends to continue to defend these matters vigorously.

Labor Contracts On April 17, 2010, the Company and the Communications Workers of America announced a tentative agreement covering approximately 11,200 Mobility employees in the nine-state former BellSouth Corporation (BellSouth) region (Mobility Southeast Region) subject to ratification by covered employees. This agreement was ratified on May 28, 2010. The agreement provides for a four-year term with general wage increase of 2.75 percent in year one, 2.25 percent in year two, and 2.5 percent in each of years three and four (2012 – 2013). The agreement includes traditional work rules and wages only.

COMPETITIVE AND REGULATORY ENVIRONMENT

Overview AT&T subsidiaries operating within the U.S. are subject to federal and state regulatory authorities. AT&T subsidiaries operating outside the U.S. are subject to the jurisdiction of national and supranational regulatory authorities in the markets where service is provided, and regulation is generally limited to operational licensing authority for the provision of services to enterprise customers.

In the Telecommunications Act of 1996 (Telecom Act), Congress established a national policy framework intended to bring the benefits of competition and investment in advanced telecommunications facilities and services to all Americans by opening all telecommunications markets to competition and reducing or eliminating regulatory burdens that harm consumer welfare. However, since the Telecom Act was passed, the FCC and some state regulatory commissions have maintained certain regulatory requirements that were imposed decades ago on our traditional wireline subsidiaries when they operated as legal monopolies. Where appropriate, we are pursuing additional legislative and regulatory measures to reduce regulatory burdens that inhibit our ability to compete more effectively and offer services wanted and needed by our customers. For example, we are supporting efforts to update and improve regulatory treatments for retail services. Passage of legislation is uncertain and depends on many factors.

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The current Commission appears to be more open than the prior Commission to maintaining or expanding regulatory requirements on entities subject to its jurisdiction. In addition, Congress, the President and the FCC all have declared a national policy objective of ensuring that all Americans have access to broadband technologies and services. In 2009, Congress charged the FCC with developing a National Broadband Plan, which the FCC delivered to Congress on March 16, 2010. The Plan is broad in scope and proposes a detailed strategy for expanding deployment and adoption of broadband facilities and services. It contains a series of recommendations for future action by the FCC, Congress and other governmental agencies, including dozens of rulemaking proceedings at the FCC over the course of the next 12 to 18 months. The proceedings will affect all segments of the communications industry and may encompass proposed rules and policies relating to universal service support, intercarrier compensation, unbundling of broadband facilities/services, data roaming and regulation of special access services and other high capacity services as well as a variety of other areas that could have an impact on AT&T's operations and revenues. However, at this stage, it is too early to assess what, if any, impact such proposed changes could have on us.

Our wireless operations operate in robust competitive markets but are likewise subject to substantial governmental regulation. Wireless communications providers must be licensed by the FCC to provide communications services at specified spectrum frequencies within specified geographic areas and must comply with the rules and policies governing the use of the spectrum as adopted by the FCC. The FCC has recognized the importance of providing carriers with access to adequate spectrum to permit continued wireless growth and has begun investigating how to develop policies to promote that goal. While wireless communications providers' prices and service offerings are generally not subject to state regulation, an increasing number of states are attempting to regulate or legislate various aspects of wireless services, such as in the area of consumer protection.

AT&T has previously noted that the broadband marketplace is robustly competitive and that we do not block consumers from accessing the lawful Internet sites of their choice. We therefore believe that prescriptive "net neutrality" rules are not only unnecessary but also counterproductive to the extent they would restrict broadband Internet access providers from developing innovative new services for consumers and/or content and application providers. Nor do we believe that wireless providers should be prohibited from entering into exclusive arrangements with handset manufacturers or that government should regulate wireless early termination fees. It is widely recognized that the wireless industry in the United States is characterized by innovation, differentiation, declining prices and extensive competition among handset manufacturers, service providers and applications. For this reason, additional broadband regulation and new wireless requirements are unwarranted.

Net Neutrality In 2009, the FCC adopted a Notice of Proposed Rulemaking (NPRM) seeking comment on six proposed "net neutrality" rules that are intended to preserve the "free and open Internet." The proposed rules apply to providers of "broadband Internet access service" and state that, subject to "reasonable network management," such a provider:

- May not prevent any of its users from sending or receiving the lawful content of the user's choice over the Internet.
- May not prevent any of its users from running the lawful applications or using the lawful services of the user's choice.
- May not prevent any of its users from connecting to and using on its network the user's choice of lawful devices that do not harm the network.
-

May not deprive any of its users of the user's entitlement to competition among network providers, application providers, service providers and content providers.

- Must treat lawful content, applications and services in a nondiscriminatory manner.
- Must disclose such information concerning network management and other practices as is reasonably required for users and content, application and service providers to enjoy the protections specified in these rules.

The NPRM states that the proposed rules would apply to all platforms over which broadband Internet access services are provided, including mobile wireless broadband, while recognizing that different platforms involve significantly different technologies, market structures, patterns of consumer usage and regulatory history. The comment cycle on the NPRM concluded in the second quarter of 2010.

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On April 6, 2010, the D.C. Circuit vacated the FCC's 2008 Comcast Order, in which the FCC concluded that Comcast unlawfully had interfered with its cable modem customers' use of certain peer-to-peer applications, in violation of the FCC's net neutrality principles. The court found that the FCC failed to show it had authority to enforce those principles against Comcast. Following the decision, the FCC issued the broadband reclassification Notice of Inquiry described below.

Broadband Reclassification In June 2010, the FCC adopted a Notice of Inquiry seeking comment on whether it should "reclassify" wired and wireless broadband Internet access services for regulatory purposes. Currently, broadband Internet access services are classified as minimally regulated "information services" under Title I of the Communications Act. To provide itself with additional regulatory authority following the D.C. Circuit's decision in the Comcast case (discussed above), the FCC asks whether it should now reclassify broadband Internet access service as consisting of two separate components: (i) a transmission component, known as "Internet connectivity service," which would be classified as a "telecommunications service" subject to traditional telephone company regulation under Title II of the Act, and (ii) an information processing component, known as "broadband Internet service," which would be classified as a minimally regulated Title I information service. The FCC proposes to abstain from applying numerous provisions of Title II to the Internet connectivity service, but it also proposes to retain several traditional core regulations from Title II, including pricing and nondiscrimination requirements. We strongly oppose any efforts to reclassify this service and have filed comments opposing this approach by the FCC. Given the uncertainty regarding the definition of "Internet connectivity service", the types of regulations that would apply to such a service, and the many arguments against the proposal, including challenges to the FCC's legal authority to reclassify this service, we are unable to determine the impact of this proceeding on our operating results and financial conditions at this time.

LIQUIDITY AND CAPITAL RESOURCES

We had \$1,377 in cash and cash equivalents available at June 30, 2010. Cash and cash equivalents included cash of \$370 and money market funds and other cash equivalents of \$1,007. In the first six months of 2010, cash inflows were primarily provided by cash receipts from operations and the issuance of commercial paper. These inflows were offset by cash used to meet the needs of the business, including, but not limited to, payment of operating expenses, funding capital expenditures, acquisitions, dividends to stockholders, the repayment of debt and the payment of interest on debt. We discuss many of these factors in detail below.

Cash Provided by or Used in Operating Activities

In the first six months of 2010, cash provided by operating activities was \$15,810 which is comparable to \$15,772 in the first six months of 2009.

Cash Used in or Provided by Investing Activities

In the first six months of 2010, cash used in investing activities consisted primarily of \$7,856 for capital expenditures, \$379 for interest during construction, \$2,372 cash paid for the acquisition of Verizon assets and \$175 for additional spectrum. In addition, the company's Rabbi Trusts invested \$347 of cash on hand into various investments and the company purchased an additional \$202 of América Móvil shares. Our capital expenditures are primarily for our wireless and wireline networks and support systems for our communications services. Capital spending excluding interest during construction in our wireless segment increased 56% in the first six months. Expenditures were used for network capacity expansion, integration and upgrades to our Universal Mobile Telecommunications

System/High-Speed Packet Access network and the initial deployment of long-term evolution (4G) equipment for trials. The Wireline segment represents 61% of the total capital expenditures, excluding interest during construction. Wireline capital expenditures decreased 5% in the first six months compared to the previous year reflecting decreased spending on U-verse services as the upgrades to our existing network become more mature.

We continue to expect that our 2010 capital expenditures will be in the range of \$18,000 to \$19,000, assuming that the regulatory environment remains favorable for investment. We continue to expect to fund 2010 capital expenditures for our wireless and wireline segments, including international operations, using cash from operations and incremental borrowings, depending on interest rate levels and overall market conditions. The amount of capital investment is influenced by demand for services and products, continued growth and regulatory considerations.

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Cash Used in or Provided by Financing Activities

In the first six months of 2010, our financing activities primarily consisted of the payment of dividends, the repayment of debt and the transfer of collateral (see Note 6 for collateral discussion).

In the first six months of 2010, we paid dividends of \$4,960 compared with \$4,834 in the first six months of 2009, primarily reflecting an increase in the quarterly dividend approved by our Board of Directors in December 2009. Dividends declared by our Board of Directors totaled \$0.42 per share in the second quarter of 2010 and \$0.41 per share in the second quarter of 2009. Our dividend policy considers the expectations and requirements of stockholders, internal requirements of AT&T and long-term growth opportunities. It is our intent to provide the financial flexibility to allow our Board of Directors to consider dividend growth and to recommend an increase in dividends to be paid in future periods. All dividends remain subject to declaration by our Board of Directors.

In the first six months of 2010, we repaid \$4,661 of long-term debt.

In the first six months of 2010, we funded our financing activities primarily through cash from operations, net proceeds of \$3,280 from the issuance of commercial paper and other short-term borrowings, and cash on hand.

At June 30, 2010, we had \$9,721 debt maturing within one year, which included \$6,408 of long-term debt maturities and \$3,313 of commercial paper and other short-term borrowings. Debt maturing within one year includes \$1,000 of annual put reset securities issued by BellSouth that may be put back to us by the holders each April until maturity in 2021. In July 2010, we issued \$2,250 of 2.50% global notes due 2015 for proceeds of approximately \$2,235. In August 2010, we announced a private offer to exchange any and all of the outstanding 8.750% senior notes of New Cingular Wireless Services, Inc. due 2031 and, subject to pro-ration, the outstanding 8.00% senior notes of AT&T Corp. due 2031, for a new series of AT&T Inc. notes due 2040 and cash. The offer is subject to conditions, including that we receive a minimum principal amount of \$500 in the exchange.

At June 30, 2010, our debt ratio was 40.3% compared to 43.7% at June 30, 2009 and 41.3% at December 31, 2009. The decreased debt ratio from a year ago is due to a \$6,722 decrease in debt and a \$4,471 increase in stockholders' equity. The decreased debt ratio from December 31, 2009 is due to a \$2,083 decrease in debt and a \$1,162 increase in stockholders' equity.

We have a \$9,465 credit agreement with a syndicate of investment and commercial banks, which we have the right to increase up to an additional \$2,535, provided no event of default under the credit agreement has occurred. The current agreement will expire in July 2011. We also have the right to terminate, in whole or in part, amounts committed by the lenders under this agreement in excess of any outstanding advances; however, any such terminated commitments may not be reinstated. Advances under this agreement may be used for general corporate purposes, including support of commercial paper borrowings and other short-term borrowings. We must maintain a debt-to-EBITDA (earnings before interest, income taxes, depreciation and amortization, and other modifications described in the agreement) financial ratio covenant of not more than three-to-one as of the last day of each fiscal quarter for the four quarters then ended. We comply with all covenants under the agreement. At June 30, 2010, we had no borrowings outstanding under this agreement.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk
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At June 30, 2010, we had interest rate swaps with a notional value of \$11,250 and a fair value of \$602.

We have fixed-to-fixed cross-currency swaps on foreign-currency-denominated debt instruments with a U.S. dollar notional value of \$7,502 to hedge our exposure to changes in foreign currency exchange rates. These derivatives have been designated at inception and qualify as cash flow hedges with a net fair value of \$(906) at June 30, 2010. We have rate locks with a notional value of \$3,400 and a net fair value of \$(290) and foreign exchange contracts with a notional value of \$229 and a net fair value of \$(16) at June 30, 2010.

Item 4. Controls and Procedures

The registrant maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the registrant is recorded, processed, summarized, accumulated and communicated to its management, including its principal executive and principal financial officers, to allow timely decisions regarding required disclosure, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. The chief executive officer and chief financial officer have performed an evaluation of the effectiveness of the design and operation of the registrant's disclosure controls and procedures as of June 30, 2010. Based on that evaluation, the chief executive officer and chief financial officer concluded that the registrant's disclosure controls and procedures were effective as of June 30, 2010.

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CAUTIONARY LANGUAGE CONCERNING FORWARD-LOOKING STATEMENTS

Information set forth in this report contains forward-looking statements that are subject to risks and uncertainties, and actual results could differ materially. Many of these factors are discussed in more detail in the “Risk Factors” section. We claim the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

The following factors could cause our future results to differ materially from those expressed in the forward-looking statements:

- Adverse economic and/or capital access changes in the markets served by us or in countries in which we have significant investments, including the impact on customer demand and our ability and our suppliers’ ability to access financial markets.
- Changes in available technology and the effects of such changes, including product substitutions and deployment costs.
- Increases in our benefit plans’ costs, including increases due to adverse changes in the U.S. and foreign securities markets, resulting in worse-than-assumed investment returns and discount rates, and adverse medical cost trends and unfavorable health care legislation and regulations.
- The final outcome of Federal Communications Commission and other federal agency proceedings and reopenings of such proceedings and judicial review, if any, of such proceedings, including issues relating to access charges, broadband deployment, reclassification of broadband as a Title II service, E911 services, competition, net neutrality, unbundled loop and transport elements, wireless license awards and renewals and wireless services.
- The final outcome of regulatory proceedings in the states in which we operate and reopenings of such proceedings and judicial review, if any, of such proceedings, including proceedings relating to Interconnection terms, access charges, universal service, unbundled network elements and resale and wholesale rates, broadband deployment including our U-verse services, net neutrality, performance measurement plans, service standards and traffic compensation.
- Enactment of additional state, federal and/or foreign regulatory and tax laws and regulations pertaining to our subsidiaries and foreign investments, including laws and regulations that reduce our incentive to invest in our networks, resulting in lower revenue growth and/or higher operating costs.
- Our ability to absorb revenue losses caused by increasing competition, including offerings that use alternative technologies (e.g., cable, wireless and VoIP) and our ability to maintain capital expenditures.
- The extent of competition and the resulting pressure on access line totals and wireline and wireless operating margins.
- Our ability to develop attractive and profitable product/service offerings to offset increasing competition in our wireless and wireline markets.
- The ability of our competitors to offer product/service offerings at lower prices due to lower cost structures and regulatory and legislative actions adverse to us, including state regulatory proceedings relating to unbundled network elements and nonregulation of comparable alternative technologies (e.g., VoIP).
- The timing, extent and cost of deployment of our U-verse services; the development of attractive and profitable service offerings; the extent to which regulatory, franchise fees and build-out requirements apply to this initiative; and the availability, cost and/or reliability of the various technologies and/or content required to provide such offerings.
- Our continued ability to attract and offer a diverse portfolio of devices, some on an exclusive basis.
- The availability and cost of additional wireless spectrum and regulations relating to licensing and technical standards and deployment and usage, including network management rules.

- Our ability to manage growth in wireless data services, including network quality.
- The outcome of pending or threatened litigation, including patent and product safety claims by or against third parties.
- The impact on our networks and business from major equipment failures, our inability to obtain equipment/software or have equipment/software serviced in a timely and cost-effective manner from suppliers, severe weather conditions, natural disasters, pandemics, energy shortages, wars or terrorist attacks.
- The issuance by the Financial Accounting Standards Board or other accounting oversight bodies of new accounting standards or changes to existing standards.
- The issuance by the Internal Revenue Service and/or state tax authorities of new tax regulations or changes to existing standards and actions by federal, state or local tax agencies and judicial authorities with respect to applying applicable tax laws and regulations and the resolution of disputes with any taxing jurisdictions.
- Our ability to adequately fund our wireless operations, including payment for additional spectrum; network upgrades and technological advancements.
- Changes in our corporate strategies, such as changing network requirements or acquisitions and dispositions, to respond to competition and regulatory, legislative and technological developments.

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially affect our future earnings.

AT&T INC.
JUNE 30, 2010

PART II – OTHER INFORMATION

Dollars in millions except per share amounts

Item 1A. Risk Factors

We discuss in our Annual Report on Form 10-K various risks that may materially affect our business. We use this section to update this discussion to reflect material developments since our Form 10-K was filed. For the second quarter 2010, there were no such material developments.

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AT&T INC.
JUNE 30, 2010

Item 6. Exhibits

Exhibits identified in parentheses below, on file with the Securities and Exchange Commission, are incorporated by reference as exhibits hereto. Unless otherwise indicated, all exhibits so incorporated are from File No. 1-8610.

- 10a Cash Deferral Plan, amended and restated June 24, 2010
- 10b Stock Purchase and Deferral Plan, amended and restated June 24, 2010
- 10c 2006 Incentive Plan, amended and restated January 28, 2010
- 12 Computation of Ratios of Earnings to Fixed Charges
- 31 Rule 13a-14(a)/15d-14(a) Certifications
 - 31.1 Certification of Principal Executive Officer
 - 31.2 Certification of Principal Financial Officer
- 32 Section 1350 Certifications
- 101 XBRL Instance Document

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AT&T Inc.

August 6, 2010
Richard G. Lindner
Senior Executive Vice President

/s/ Richard G. Lindner