

AT&T INC.
Form 10-Q
August 04, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

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.

Large accelerated filer [X]

Accelerated filer

[]

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes

No

At July 31, 2016 there were 6,152 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 | | Six months ended | |
|--|---------------------------|----------|------------------|----------|
| | ended June 30, 2016 | 2015 | June 30, 2016 | 2015 |
| Operating Revenues | | | | |
| Service | \$37,142 | \$29,541 | \$74,243 | \$58,503 |
| Equipment | 3,378 | 3,474 | 6,812 | 7,088 |
| Total operating revenues | 40,520 | 33,015 | 81,055 | 65,591 |
| Operating Expenses | | | | |
| Cost of services and sales | | | | |
| Equipment | 4,260 | 4,353 | 8,635 | 8,899 |
| Broadcast, programming and operations | 4,701 | 1,148 | 9,330 | 2,270 |
| Other cost of services (exclusive of depreciation and amortization shown separately below) | 9,514 | 9,578 | 18,910 | 18,390 |
| Selling, general and administrative | 8,909 | 7,467 | 17,350 | 15,428 |
| Depreciation and amortization | 6,576 | 4,696 | 13,139 | 9,274 |
| Total operating expenses | 33,960 | 27,242 | 67,364 | 54,261 |
| Operating Income | 6,560 | 5,773 | 13,691 | 11,330 |
| Other Income (Expense) | | | | |
| Interest expense | (1,258) | (932) | (2,465) | (1,831) |
| Equity in net income of affiliates | 28 | 33 | 41 | 33 |
| Other income (expense) – net | 91 | 48 | 161 | 118 |
| Total other income (expense) | (1,139) | (851) | (2,263) | (1,680) |
| Income Before Income Taxes | 5,421 | 4,922 | 11,428 | 9,650 |
| Income tax expense | 1,906 | 1,738 | 4,028 | 3,127 |
| Net Income | 3,515 | 3,184 | 7,400 | 6,523 |
| Less: Net Income Attributable to Noncontrolling Interest | (107) | (102) | (189) | (178) |
| Net Income Attributable to AT&T | \$3,408 | \$3,082 | \$7,211 | \$6,345 |
| Basic Earnings Per Share Attributable to AT&T | \$0.55 | \$0.59 | \$1.17 | \$1.22 |
| Diluted Earnings Per Share Attributable to AT&T | \$0.55 | \$0.59 | \$1.17 | \$1.22 |
| Weighted Average Number of Common Shares | | | | |
| Outstanding – Basic (in millions) | 6,174 | 5,204 | 6,173 | 5,204 |
| Weighted Average Number of Common Shares | | | | |
| Outstanding – with Dilution (in millions) | 6,195 | 5,220 | 6,193 | 5,220 |
| Dividends Declared Per Common Share | \$0.48 | \$0.47 | \$0.96 | \$0.94 |
| See Notes to Consolidated Financial Statements. | | | | |

AT&T INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE
 INCOME

Dollars in millions
 (Unaudited)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------------|---------|---------------------------------|----------|
| | 2016 | 2015 | 2016 | 2015 |
| Net income | \$3,515 | \$3,184 | \$7,400 | \$6,523 |
| Other comprehensive income (loss), net of tax: | | | | |
| Foreign Currency: | | | | |
| Foreign currency translation adjustment, net of taxes of \$136, \$1, \$126 and \$(103) | 218 | 1 | 174 | (185) |
| Available-for-sale securities: | | | | |
| Net unrealized gains (losses), net of taxes of \$2, \$0, \$(13) and \$19 | 5 | 1 | (21) | 34 |
| Reclassification adjustment included in net income, net of taxes of \$2, \$(2), \$0 and \$(5) | 3 | (4) | - | (9) |
| Cash flow hedges: | | | | |
| Net unrealized gains (losses), net of taxes of \$(208), \$(52), \$(141) and \$(242) | (387) | (95) | (263) | (449) |
| Reclassification adjustment included in net income, net of taxes of \$5, \$5, \$10 and \$9 | 9 | 10 | 19 | 17 |
| Defined benefit postretirement plans: | | | | |
| Amortization of net prior service credit included in net income, net of taxes of \$(131), \$(131), \$(262) and \$(262) | (214) | (214) | (429) | (429) |
| Other comprehensive income (loss) | (366) | (301) | (520) | (1,021) |
| Total comprehensive income | 3,149 | 2,883 | 6,880 | 5,502 |
| Less: Total comprehensive income attributable to noncontrolling interest | (107) | (102) | (189) | (178) |
| Total Comprehensive Income Attributable to AT&T | \$3,042 | \$2,781 | \$6,691 | \$5,324 |

See Notes to Consolidated Financial Statements.

AT&T INC.

CONSOLIDATED BALANCE SHEETS

Dollars in millions except per share amounts

| | June 30, 2016 (Unaudited) | December 31, 2015 |
|--|---------------------------------|-------------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 7,208 | \$ 5,121 |
| Accounts receivable - net of allowances for doubtful accounts of \$642 and \$704 | 15,830 | 16,532 |
| Prepaid expenses | 1,197 | 1,072 |
| Other current assets | 11,770 | 13,267 |
| Total current assets | 36,005 | 35,992 |
| Property, plant and equipment | 313,018 | 306,227 |
| Less: accumulated depreciation and amortization | (189,481) | (181,777) |
| Property, Plant and Equipment – Net | 123,537 | 124,450 |
| Goodwill | 105,252 | 104,568 |
| Licenses | 94,098 | 93,093 |
| Customer Lists and Relationships - Net | 16,259 | 18,208 |
| Other Intangible Assets – Net | 9,107 | 9,409 |
| Investments in Equity Affiliates | 1,677 | 1,606 |
| Other Assets | 15,873 | 15,346 |
| Total Assets | \$ 401,808 | \$ 402,672 |
| Liabilities and Stockholders' Equity | | |
| Current Liabilities | | |
| Debt maturing within one year | \$ 9,528 | \$ 7,636 |
| Accounts payable and accrued liabilities | 26,746 | 30,372 |
| Advanced billing and customer deposits | 4,465 | 4,682 |
| Accrued taxes | 2,773 | 2,176 |
| Dividends payable | 2,953 | 2,950 |
| Total current liabilities | 46,465 | 47,816 |
| Long-Term Debt | 117,308 | 118,515 |
| Deferred Credits and Other Noncurrent Liabilities | | |
| Deferred income taxes | 58,216 | 56,181 |
| Postemployment benefit obligation | 34,023 | 34,262 |
| Other noncurrent liabilities | 21,425 | 22,258 |
| Total deferred credits and other noncurrent liabilities | 113,664 | 112,701 |
| Stockholders' Equity | | |
| Common stock (\$1 par value, 14,000,000,000 authorized at June 30, 2016 and December 31, 2015; issued 6,495,231,088 at June 30, 2016 and December 31, 2015) | 6,495 | 6,495 |
| Additional paid-in capital | 89,486 | 89,763 |
| Retained earnings | 34,950 | 33,671 |
| Treasury stock (343,397,505 at June 30, 2016 and 350,291,239 at December 31, 2015, at cost) | (12,343) | (12,592) |
| Accumulated other comprehensive income | 4,814 | 5,334 |
| Noncontrolling interest | 969 | 969 |
| Total stockholders' equity | 124,371 | 123,640 |
| Total Liabilities and Stockholders' Equity | \$ 401,808 | \$ 402,672 |
| See Notes to Consolidated Financial Statements. | | |

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

| | Six months ended June 30, | |
|---|------------------------------|----------|
| | 2016 | 2015 |
| Operating Activities | | |
| Net income | \$7,400 | \$6,523 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 13,139 | 9,274 |
| Undistributed earnings from investments in equity affiliates | (22) | (23) |
| Provision for uncollectible accounts | 705 | 535 |
| Deferred income tax expense | 1,767 | 1,244 |
| Net gain from sale of investments, net of impairments | (85) | (50) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 543 | 434 |
| Other current assets | 1,069 | 732 |
| Accounts payable and accrued liabilities | (3,059) | (1,125) |
| Retirement benefit funding | (280) | (455) |
| Other - net | (2,970) | (1,191) |
| Total adjustments | 10,807 | 9,375 |
| Net Cash Provided by Operating Activities | 18,207 | 15,898 |
| Investing Activities | | |
| Capital expenditures: | | |
| Purchase of property and equipment | (9,702) | (8,328) |
| Interest during construction | (437) | (339) |
| Acquisitions, net of cash acquired | (485) | (20,954) |
| Dispositions | 107 | 72 |
| Sale of securities, net | 500 | 1,890 |
| Other | - | (1) |
| Net Cash Used in Investing Activities | (10,017) | (27,660) |
| Financing Activities | | |
| Issuance of long-term debt | 10,140 | 33,958 |
| Repayment of long-term debt | (9,129) | (2,919) |
| Purchase of treasury stock | (197) | - |
| Issuance of treasury stock | 119 | 20 |
| Dividends paid | (5,899) | (4,873) |
| Other | (1,137) | (2,071) |
| Net Cash (Used in) Provided by Financing Activities | (6,103) | 24,115 |
| Net increase in cash and cash equivalents | 2,087 | 12,353 |
| Cash and cash equivalents beginning of year | 5,121 | 8,603 |
| Cash and Cash Equivalents End of Period | \$7,208 | \$20,956 |
| Cash paid (received) during the six months ended June 30 for: | | |
| Interest | \$2,914 | \$2,178 |
| Income taxes, net of refunds | \$2,468 | \$(71) |

See Notes to Consolidated Financial Statements.

AT&T INC.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

Dollars and shares in millions except per share amounts

(Unaudited)

| | June 30, 2016 | |
|--|---------------|-------------|
| | Shares | Amount |
| Common Stock | | |
| Balance at beginning of year | 6,495 | \$6,495 |
| Issuance of stock | - | - |
| Balance at end of period | 6,495 | \$6,495 |
| Additional Paid-In Capital | | |
| Balance at beginning of year | | \$89,763 |
| Issuance of treasury stock | | (43) |
| Share-based payments | | (258) |
| Change related to acquisition of interests held by noncontrolling owners | | 24 |
| Balance at end of period | | \$89,486 |
| Retained Earnings | | |
| Balance at beginning of year | | \$33,671 |
| Net income attributable to AT&T (\$1.17 per diluted share) | | 7,211 |
| Dividends to stockholders (\$0.96 per share) | | (5,932) |
| Balance at end of period | | \$34,950 |
| Treasury Stock | | |
| Balance at beginning of year | (350) | \$(12,592) |
| Repurchase and acquisition of common stock | (7) | (294) |
| Issuance of treasury stock | 14 | 543 |
| Balance at end of period | (343) | \$(12,343) |
| Accumulated Other Comprehensive Income Attributable to AT&T, net of tax | | |
| Balance at beginning of year | | \$5,334 |
| Other comprehensive loss attributable to AT&T | | (520) |
| Balance at end of period | | \$4,814 |
| Noncontrolling Interest | | |
| Balance at beginning of year | | \$969 |
| Net income attributable to noncontrolling interest | | 189 |
| Distributions | | (164) |
| Acquisition of interest held by noncontrolling owners | | (25) |
| Balance at end of period | | \$969 |
| Total Stockholders' Equity at beginning of year | | \$123,640 |
| Total Stockholders' Equity at end of period | | \$124,371 |
| See Notes to Consolidated Financial Statements. | | |

AT&T INC.
JUNE 30, 2016

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." These consolidated financial statements include all adjustments that are necessary to present fairly the results for the presented interim periods, consisting of normal recurring accruals and other items. 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, 2015.

The consolidated financial statements include the accounts of the Company and our majority-owned subsidiaries and affiliates, including the results of DIRECTV and wireless properties in Mexico for the period from acquisition to the reporting date. Our subsidiaries and affiliates operate in the communications and digital entertainment services industry, providing services and equipment that deliver voice, video and broadband services domestically and internationally.

All significant intercompany transactions are eliminated in the consolidation process. Investments in less than majority-owned subsidiaries and partnerships where we have significant influence are accounted for under the equity method. Earnings from certain investments accounted for using the equity method are included for periods ended within up to one quarter of our period end. We also record our proportionate share of our equity method investees' other comprehensive income (OCI) items, including cumulative translation adjustments.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) 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. Certain prior period amounts have been conformed to the current period's presentation, including our 2015 change in accounting to capitalize customer set-up and installation costs and amortize them over the expected economic life of the customer relationship. The consolidated statements of income also include revisions to present "Equipment" and "Broadcast, programming and operations" costs separately from "Other cost of services."

Leases In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, "Leases (Topic 842)" (ASU 2016-02), which replaces existing leasing rules with a comprehensive lease measurement and recognition standard and expanded disclosure requirements. ASU 2016-02 will require lessees to recognize most leases on their balance sheets as liabilities, with corresponding "right-of-use" assets. Leases will be classified as either a finance or an operating lease without relying upon the bright-line tests under current GAAP.

Upon initial evaluation, we believe the key change upon adoption will be the balance sheet recognition. The income statement recognition appears similar to our current methodology.

ASU 2016-02 becomes effective for annual reporting periods beginning after December 15, 2018, subject to early adoption. We have just begun our evaluation of the impact on our financial statements, as well as available adoption methods, but we believe our implementation of the revenue recognition standard discussed below could influence the timing of our adoption of ASU 2016-02.

Revenue Recognition In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" (ASU 2014-09) and has since modified the standard four times. These standards replace existing revenue

recognition rules with a comprehensive revenue measurement and recognition standard and expanded disclosure requirements. ASU 2014-09, as amended, becomes effective for annual reporting periods beginning after December 15, 2017, at which point we plan to adopt the standard.

The FASB allows two adoption methods under ASU 2014-09. Under one method, a company will apply the rules to contracts in all reporting periods presented, subject to certain allowable exceptions. Under the other method, a company will apply the rules to all contracts existing as of January 1, 2018, recognizing in beginning retained earnings an adjustment for the cumulative effect of the change and providing additional disclosures comparing results to previous rules ("modified retrospective method"). We continue to evaluate the available adoption methods.

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

Upon initial evaluation, we believe the key changes in the standard that impact our revenue recognition relate to the allocation of contract revenues between various services and equipment, and the timing of when those revenues are recognized. We are still in the process of evaluating these impacts. As a result of our accounting policy change for customer set-up and installation costs in 2015, we believe under the new standard that the requirement to defer such costs will not result in a significant change to our results. However, the requirement to defer incremental contract acquisition costs and recognize them over the contract period or expected customer life will result in the recognition of a deferred charge on our balance sheets. We cannot currently estimate the impact of this change upon adoption, as the industry continues to undergo changes in how devices and services are sold to customers.

Customer Fulfillment Costs During the second quarter of 2016, we updated our analysis of the economic lives of customer relationships, which included a review of satellite customer data following the DIRECTV acquisition. As of April 1, 2016, to better reflect the estimated economic lives of satellite and certain business customer relationships, we extended the period to approximately 4.5 years. This change in accounting estimate decreased other cost of services and impacted net income \$82, or \$0.01 per diluted share, in the second quarter of 2016.

NOTE 2. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic and diluted earnings per share for the three and six months ended June 30, 2016 and 2015, is shown in the table below:

| | Three months ended June 30, 2016 | | Six months ended June 30, 2015 | |
|--|---|---------|---|---------|
| Numerators | | | | |
| Numerator for basic earnings per share: | | | | |
| Net Income | \$3,515 | \$3,184 | \$7,400 | \$6,523 |
| Less: Net income attributable to noncontrolling interest | (107) | (102) | (189) | (178) |
| Net Income attributable to AT&T | 3,408 | 3,082 | 7,211 | 6,345 |
| Dilutive potential common shares: | | | | |
| Share-based payment | 2 | 2 | 6 | 6 |
| Numerator for diluted earnings per share | \$3,410 | \$3,084 | \$7,217 | \$6,351 |
| Denominators (000,000) | | | | |
| Denominator for basic earnings per share: | | | | |
| Weighted average number of common shares outstanding | 6,174 | 5,204 | 6,173 | 5,204 |
| Dilutive potential common shares: | | | | |
| Share-based payment (in shares) | 21 | 16 | 20 | 16 |
| Denominator for diluted earnings per share | 6,195 | 5,220 | 6,193 | 5,220 |
| Basic earnings per share attributable to AT&T | \$0.55 | \$0.59 | \$1.17 | \$1.22 |
| Diluted earnings per share attributable to AT&T | \$0.55 | \$0.59 | \$1.17 | \$1.22 |

NOTE 3. OTHER COMPREHENSIVE INCOME

Changes in the balances of each component included in accumulated other comprehensive income (accumulated OCI) are presented below. All amounts are net of tax and exclude noncontrolling interest.

Following our 2015 acquisitions of DIRECTV and wireless businesses in Mexico, we have additional foreign operations that are exposed to fluctuations in the exchange rates used to convert operations, assets and liabilities into U.S. dollars. Since December 31, 2015, when compared to the U.S. dollar, the Brazilian real exchange rate has appreciated 18.9%, the Argentine peso exchange rate has depreciated 16.4% and the Mexican peso exchange rate has depreciated 6.2%.

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AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

| Foreign Currency Translation Adjustment | Net Unrealized Gains (Losses) on Available- for-Sale Securities | Net Unrealized Gains (Losses) on Cash Flow Hedges | Defined Benefit Postretirement Plans | Accumulated Other Comprehensive Income |
|---|--|---|---|---|
| Balance as of December 31, 2015 | \$ 484 | \$ 16 | \$ 6,032 | \$ 5,334 |
| Other comprehensive income (loss) before reclassifications | (21) | (263) | - | (110) |
| Amounts reclassified from accumulated OCI | ¹ - | ² 19 | ³ (429) | ⁴ (410) |
| Net other comprehensive income (loss) | (21) | (244) | (429) | (520) |
| Balance as of June 30, 2016 | \$ 463 | \$ (228) | \$ 5,603 | \$ 4,814 |

| Foreign Currency Translation Adjustment | Net Unrealized Gains (Losses) on Available- for-Sale Securities | Net Unrealized Gains (Losses) on Cash Flow Hedges | Defined Benefit Postretirement Plans | Accumulated Other Comprehensive Income |
|--|--|---|---|---|
|--|--|---|---|---|

| | | | | | | | | | |
|--|------------------|-----------------|--------------------|--------------------|--|--|--|--|--|
| Balance as of December 31, 2014 | | | | | | | | | |
| of \$ (26) | \$ 499 | \$ 741 | \$ 6,847 | \$ 8,061 | | | | | |
| Other comprehensive income (185) (loss) | 34 | (449) | - | (600) | | | | | |
| before reclassifications | | | | | | | | | |
| Amounts reclassified from | ¹ (9) | ² 17 | ³ (429) | ⁴ (421) | | | | | |
| accumulated OCI | | | | | | | | | |
| Net other comprehensive income (185) (loss) | 25 | (432) | (429) | (1,021) | | | | | |
| Balance as of June 30, 2015 | \$ 524 | \$ 309 | \$ 6,418 | \$ 7,040 | | | | | |

¹ Translation (gain) loss reclassifications are included in Other income (expense) - net in the consolidated statements of income.

² (Gains) losses are included in Other income (expense) - net in the consolidated statements of income.

³ (Gains) losses are included in Interest expense in the consolidated statements of income. See Note 6 for additional information.

⁴ The amortization of prior service credits associated with postretirement benefits, net of amounts capitalized as part of construction labor, are included in Cost of services and sales and Selling, general and administrative in the consolidated statements of income (see Note 5).

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer products and services to different customer segments over various technology platforms and/or in different geographies that are managed accordingly. Due to organizational changes and our July 24, 2015 acquisition of DIRECTV, effective for the quarter ended September 30, 2015, we revised our operating segments to align with our new management structure and organizational responsibilities. We analyze our operating segments based on Segment Contribution, which consists of operating income, excluding acquisition-related costs and other significant items (as discussed below), and equity in net income (loss) of affiliates for investments managed within each operating segment. We have four reportable segments: (1) Business Solutions, (2) Entertainment Group, (3) Consumer Mobility and (4) International.

We also evaluate segment performance based on Segment Contribution, excluding equity in net income (loss) of affiliates and depreciation and amortization, which we refer to as EBITDA and/or EBITDA margin. We believe EBITDA to be a relevant and useful measurement to our investors as it is part of our internal management reporting and planning processes and it is an important metric that management uses to evaluate segment operating performance. EBITDA does not give effect to cash used for debt service requirements and thus does not reflect available funds for distributions, reinvestment or other discretionary uses. EBITDA margin is EBITDA divided by total revenues.

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

The Business Solutions segment provides services to business customers, including multinational companies; governmental and wholesale customers; and individual subscribers who purchase wireless services through employer-sponsored plans. We provide advanced IP-based services including Virtual Private Networks (VPN); Ethernet-related products and broadband, collectively referred to as strategic business services; as well as traditional data and voice products. We utilize our wireless and wired networks (referred to as "wired" or "wireline") to provide a complete communications solution to our business customers.

The Entertainment Group segment provides video, internet, voice communication, and interactive and targeted advertising services to customers located in the U.S. or in U.S. territories. We utilize our copper and IP-based wired network and/or our satellite technology.

The Consumer Mobility segment provides nationwide wireless service to consumers and wholesale and resale wireless subscribers located in the U.S. or in U.S. territories. We utilize our U.S. wireless network to provide voice and data services, including high-speed internet, video, and home monitoring services.

The International segment provides entertainment services in Latin America and wireless services in Mexico. Video entertainment services are provided to primarily residential customers using satellite technology. We utilize our regional and national wireless networks in Mexico to provide consumer and business customers with wireless data and voice communication services. Our international subsidiaries conduct business in their local currency, and operating results are converted to U.S. dollars using official exchange rates.

In reconciling items to consolidated operating income and income before income taxes, Corporate and Other includes: (1) operations that are not considered reportable segments and that are no longer integral to our operations or which we no longer actively market, and (2) impacts of corporate-wide decisions for which the individual operating segments are not being evaluated, including interest costs and expected return on plan assets for our pension and postretirement benefit plans.

Certain operating items are not allocated to our business segments, and those include:

Acquisition-related items which consist of (1) operations and support items associated with the merger and integration of newly acquired businesses and (2) the noncash amortization of intangible assets acquired in acquisitions.

Certain significant items which consist of (1) noncash actuarial gains and losses from pension and other postretirement benefits, (2) employee separation charges associated with voluntary and/or strategic offers, (3) losses resulting from abandonment or impairment of assets and (4) other items for which the segments are not being evaluated.

Interest expense and other income (expense) – net, are managed only on a total company basis and are, accordingly, reflected only in consolidated results.

Our operating assets are utilized by multiple segments and consist of our wireless and wired networks as well as an international satellite fleet. We manage our assets to provide for the most efficient, effective and integrated service to our customers, not by operating segment, and, therefore, asset information and capital expenditures by segment are not presented. Depreciation is allocated based on network usage or asset utilization by segment.

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

For the three months ended June 30, 2016

| | Revenue | Operations and Support Expenses | EBITDA | Depreciation and Amortization | Operating Income (Loss) | Equity in Net Income (Loss) of Affiliates | Segment Contribution |
|---------------------------|-----------|--|-----------|-------------------------------------|-------------------------------|---|-------------------------|
| Business Solutions | \$ 17,579 | \$ 10,857 | \$ 6,722 | \$ 2,521 | \$ 4,201 | \$ - | \$ 4,201 |
| Entertainment Group | 12,711 | 9,569 | 3,142 | 1,489 | 1,653 | (2) | 1,651 |
| Consumer Mobility | 8,186 | 4,680 | 3,506 | 932 | 2,574 | - | 2,574 |
| International | 1,828 | 1,723 | 105 | 298 | (193) | 9 | (184) |
| Segment Total | 40,304 | 26,829 | 13,475 | 5,240 | 8,235 | \$ 7 | \$ 8,242 |
| Corporate and Other | 216 | 293 | (77) | 20 | (97) | | |
| Acquisition-related items | - | 233 | (233) | 1,316 | (1,549) | | |
| Certain significant items | - | 29 | (29) | - | (29) | | |
| AT&T Inc. | \$ 40,520 | \$ 27,384 | \$ 13,136 | \$ 6,576 | \$ 6,560 | | |

For the six months ended June 30, 2016

| | Revenue | Operations and Support Expenses | EBITDA | Depreciation and Amortization | Operating Income (Loss) | Equity in Net Income (Loss) of Affiliates | Segment Contribution |
|---------------------------|-----------|--|-----------|-------------------------------------|-------------------------------|---|-------------------------|
| Business Solutions | \$ 35,188 | \$ 21,659 | \$ 13,529 | \$ 5,029 | \$ 8,500 | \$ - | \$ 8,500 |
| Entertainment Group | 25,369 | 19,147 | 6,222 | 2,977 | 3,245 | 1 | 3,246 |
| Consumer Mobility | 16,514 | 9,592 | 6,922 | 1,854 | 5,068 | - | 5,068 |
| International | 3,495 | 3,311 | 184 | 575 | (391) | 23 | (368) |
| Segment Total | 80,566 | 53,709 | 26,857 | 10,435 | 16,422 | \$ 24 | \$ 16,446 |
| Corporate and Other | 489 | 670 | (181) | 37 | (218) | | |
| Acquisition-related items | - | 528 | (528) | 2,667 | (3,195) | | |
| Certain significant items | - | (682) | 682 | - | 682 | | |
| AT&T Inc. | \$ 81,055 | \$ 54,225 | \$ 26,830 | \$ 13,139 | \$ 13,691 | | |

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

For the three months ended June 30, 2015

| | Revenue | Operations and Support Expenses | EBITDA | Depreciation and Amortization | Operating Income (Loss) | Equity in Net Income (Loss) of Affiliates | Segment Contribution |
|---------------------------|-----------|--|-----------|-------------------------------------|-------------------------------|---|-------------------------|
| Business Solutions | \$ 17,664 | \$ 10,972 | \$ 6,692 | \$ 2,460 | \$ 4,232 | \$ - | \$ 4,232 |
| Entertainment Group | 5,782 | 4,913 | 869 | 1,065 | (196) | (12) | (208) |
| Consumer Mobility | 8,755 | 5,202 | 3,553 | 934 | 2,619 | - | 2,619 |
| International | 491 | 529 | (38) | 93 | (131) | - | (131) |
| Segment Total | 32,692 | 21,616 | 11,076 | 4,552 | 6,524 | \$ (12) | \$ 6,512 |
| Corporate and Other | 323 | 236 | 87 | 24 | 63 | | |
| Acquisition-related items | - | 694 | (694) | 120 | (814) | | |
| Certain significant items | - | - | - | - | - | | |
| AT&T Inc. | \$ 33,015 | \$ 22,546 | \$ 10,469 | \$ 4,696 | \$ 5,773 | | |

For the six months ended June 30, 2015

| | Revenue | Operations and Support Expenses | EBITDA | Depreciation and Amortization | Operating Income (Loss) | Equity in Net Income (Loss) of Affiliates | Segment Contribution |
|---------------------------|-----------|--|-----------|-------------------------------------|-------------------------------|---|-------------------------|
| Business Solutions | \$ 35,221 | \$ 22,045 | \$ 13,176 | \$ 4,802 | \$ 8,374 | \$ - | \$ 8,374 |
| Entertainment Group | 11,442 | 9,772 | 1,670 | 2,130 | (460) | (18) | (478) |
| Consumer Mobility | 17,533 | 10,743 | 6,790 | 1,936 | 4,854 | - | 4,854 |
| International | 727 | 747 | (20) | 121 | (141) | - | (141) |
| Segment Total | 64,923 | 43,307 | 21,616 | 8,989 | 12,627 | \$ (18) | \$ 12,609 |
| Corporate and Other | 668 | 470 | 198 | 44 | 154 | | |
| Acquisition-related items | - | 993 | (993) | 241 | (1,234) | | |
| Certain significant items | - | 217 | (217) | - | (217) | | |
| AT&T Inc. | \$ 65,591 | \$ 44,987 | \$ 20,604 | \$ 9,274 | \$ 11,330 | | |

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

The following table is a reconciliation of Segment Contribution to "Income Before Income Taxes" reported on our consolidated statements of income.

| | Second Quarter | | Six-Month Period | |
|---|----------------|---------|------------------|---------|
| | 2016 | 2015 | 2016 | 2015 |
| Business Solutions | \$4,201 | \$4,232 | \$8,500 | \$8,374 |
| Entertainment Group | 1,651 | (208) | 3,246 | (478) |
| Consumer Mobility | 2,574 | 2,619 | 5,068 | 4,854 |
| International | (184) | (131) | (368) | (141) |
| Segment Contribution | 8,242 | 6,512 | 16,446 | 12,609 |
| Reconciling Items: | | | | |
| Corporate and Other | (97) | 63 | (218) | 154 |
| Merger and integration charges | (233) | (694) | (528) | (993) |
| Amortization of intangibles acquired | (1,316) | (120) | (2,667) | (241) |
| Employee separation charges | (29) | - | (54) | (217) |
| Gain on wireless spectrum transactions | - | - | 736 | - |
| Segment equity in net (income) loss of affiliates | (7) | 12 | (24) | 18 |
| AT&T Operating Income | 6,560 | 5,773 | 13,691 | 11,330 |
| Interest expense | 1,258 | 932 | 2,465 | 1,831 |
| Equity in net income of affiliates | 28 | 33 | 41 | 33 |
| Other income (expense) - net | 91 | 48 | 161 | 118 |
| Income Before Income Taxes | \$5,421 | \$4,922 | \$11,428 | \$9,650 |

NOTE 5. PENSION AND POSTRETIREMENT BENEFITS

Substantially all of our employees are covered by one of our noncontributory pension plans. We also provide certain medical, dental, life insurance and death benefits to certain retired employees under various plans and accrue actuarially determined postretirement benefit costs. 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 provide benefits described in the plans to employees upon their retirement.

In 2013, we made a voluntary contribution of a preferred equity interest in AT&T Mobility II LLC, the primary holding company for our domestic wireless business, to the trust used to pay pension benefits under our qualified pension plans. The preferred equity interest had a value of \$8,704 at June 30, 2016. The trust is entitled to receive cumulative cash distributions of \$560 per annum, which are distributed quarterly in equal amounts and accounted for as contributions. We distributed \$280 to the trust during the six months ended June 30, 2016. So long as we make the distributions, we will have no limitations on our ability to declare a dividend or repurchase shares. This preferred equity interest is a plan asset under ERISA and is recognized as such in the plan's separate financial statements. However, because the preferred equity interest is not unconditionally transferable to an unrelated party, it is not reflected in plan assets in our consolidated financial statements and instead has been eliminated in consolidation. We also agreed to make a cash contribution to the trust of \$175 no later than the due date of our federal income tax return for 2015.

We recognize actuarial gains and losses on pension and postretirement plan assets in our operating results at our annual measurement date of December 31, unless earlier remeasurements are required. The following table details pension and postretirement benefit costs included in operating expenses in the accompanying consolidated statements of income. A portion of these expenses is capitalized as part of internal construction projects, providing a small reduction in the net expense recorded. Service costs and prior service credits are reported in our segment results while interest costs and expected return on plan assets are included within Corporate and Other (see Note 4).

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AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

| | Three months ended | | Six months ended | |
|--|--------------------|---------|------------------|----------|
| | June 30, | | June 30, | |
| | 2016 | 2015 | 2016 | 2015 |
| Pension cost: | | | | |
| Service cost – benefits earned during the period | \$278 | \$300 | \$556 | \$599 |
| Interest cost on projected benefit obligation | 495 | 473 | 990 | 947 |
| Expected return on assets | (780) | (826) | (1,558) | (1,652) |
| Amortization of prior service credit | (25) | (26) | (51) | (52) |
| Net pension (credit) cost | \$(32) | \$(79) | \$(63) | \$(158) |
| Postretirement cost: | | | | |
| Service cost – benefits earned during the period | \$48 | \$56 | \$96 | \$111 |
| Interest cost on accumulated postretirement benefit obligation | 243 | 241 | 486 | 483 |
| Expected return on assets | (89) | (105) | (178) | (210) |
| Amortization of prior service credit | (319) | (319) | (638) | (639) |
| Net postretirement (credit) cost | \$(117) | \$(127) | \$(234) | \$(255) |
| Combined net pension and postretirement (credit) cost | \$(149) | \$(206) | \$(297) | \$(413) |

The decrease in the combined net pension and postretirement credit of \$57 in the second quarter and \$116 for the first six months of 2016 is primarily due to a lower expected return on assets resulting from a decrease in the value in the plan assets.

We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. For the second quarter ended 2016 and 2015, net supplemental pension benefits costs not included in the table above were \$24 and \$21. For the first six months of 2016 and 2015, net supplemental pension benefit costs were \$47 and \$41.

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 we have the ability to access.

Level 2 Inputs to the valuation methodology include:

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

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

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

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

The valuation methodologies described above may produce a fair value calculation that may not be indicative of future net realizable value or reflective of future fair values. We believe our valuation methods are appropriate and consistent with other market participants. The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There have been no changes in the methodologies used since December 31, 2015.

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, 2016 | | December 31, 2015 | |
|-----------------------------------|-----------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Notes and debentures ¹ | \$125,568 | \$137,112 | \$124,847 | \$128,993 |
| Bank borrowings | 4 | 4 | 4 | 4 |
| Investment securities | 2,550 | 2,550 | 2,704 | 2,704 |

¹ Includes credit agreement borrowings.

The carrying amount of debt with an original maturity of less than one year approximates market value. The fair value measurements used for notes and debentures are considered Level 2 and are determined using various methods, including quoted prices for identical or similar securities in both active and inactive markets.

Following is the fair value leveling for available-for-sale securities and derivatives as of June 30, 2016 and December 31, 2015:

| | June 30, 2016 | | | |
|------------------------------------|---------------|---------|---------|---------|
| | Level 1 | Level 2 | Level 3 | Total |
| Available-for-Sale Securities | | | | |
| Domestic equities | \$1,111 | \$- | \$- | \$1,111 |
| International equities | 547 | - | - | 547 |
| Fixed income bonds | - | 621 | - | 621 |
| Asset Derivatives ¹ | | | | |
| Interest rate swaps | - | 202 | - | 202 |
| Cross-currency swaps | - | 100 | - | 100 |
| Liability Derivatives ¹ | | | | |
| Cross-currency swaps | - | (3,821) | - | (3,821) |

¹ Derivatives designated as hedging instruments are reflected as "Other assets," "Other noncurrent liabilities" and, for a portion of interest rate swaps, "Other current assets" in our consolidated balance sheets.

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

| | December 31, 2015 | | | |
|------------------------------------|-------------------|---------|-------|---------|
| | Level | | Level | Total |
| | 1 | Level 2 | 3 | |
| Available-for-Sale Securities | | | | |
| Domestic equities | \$1,132 | \$- | \$ - | \$1,132 |
| International equities | 569 | - | - | 569 |
| Fixed income bonds | - | 680 | - | 680 |
| Asset Derivatives ¹ | | | | |
| Interest rate swaps | - | 136 | - | 136 |
| Cross-currency swaps | - | 556 | - | 556 |
| Foreign exchange contracts | - | 3 | - | 3 |
| Liability Derivatives ¹ | | | | |
| Cross-currency swaps | - | (3,466) | - | (3,466) |

¹ Derivatives designated as hedging instruments are reflected as "Other assets," "Other noncurrent liabilities" and, for a portion of interest rate swaps, "Other current assets" in our consolidated balance sheets.

Investment Securities

Our investment securities include equities, fixed income bonds and other securities. A substantial portion of the fair values of our available-for-sale securities was estimated based on quoted market prices. Investments in securities not traded on a national securities exchange are valued using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Realized gains and losses on securities are included in "Other income (expense) – net" in the consolidated statements of income using the specific identification method. Unrealized gains and losses, net of tax, on available-for-sale securities are recorded in accumulated OCI. Unrealized losses that are considered other than temporary are recorded in "Other income (expense) – net" with the corresponding reduction to the carrying basis of the investment. Fixed income investments of \$95 have maturities of less than one year, \$287 within one to three years, \$62 within three to five years and \$177 for five or more years.

Our cash equivalents (money market securities), short-term investments (certificate and time deposits) and customer deposits are recorded at amortized cost, and the respective carrying amounts approximate fair values. Short-term investments and customer deposits are recorded in "Other current assets" and our investment securities are recorded in "Other Assets" on the consolidated balance sheets.

Derivative Financial Instruments

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

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 in the consolidated statements of income. Unrealized gains on interest rate swaps are recorded at fair market value as assets, and unrealized losses on interest rate swaps are recorded at fair market value as liabilities. Changes in the fair values of the interest rate swaps are exactly offset by changes in the fair value of the underlying debt. Gains or losses realized upon early termination of our fair value hedges are recognized in interest expense. In the six months ended June 30, 2016 and June 30, 2015, no ineffectiveness was measured on interest rate swaps designated as fair value hedges.

AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

Cash Flow Hedging 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, British pound sterling, Canadian dollar and Swiss franc denominated debt. These agreements include initial and final exchanges of principal from fixed foreign currency denominations to fixed U.S. dollar denominated amounts, to be exchanged at a specified rate that is usually determined by the market spot rate upon issuance. They also include an interest rate swap of a fixed or floating foreign currency-denominated rate to a fixed U.S. dollar denominated interest rate.

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. For derivative instruments designated as cash flow hedges, the effective portion is reported as a component of accumulated OCI until reclassified into interest expense in the same period the hedged transaction affects earnings. The gain or loss on the ineffective portion is recognized as "Other income (expense) – net" in the consolidated statements of income in each period. We evaluate the effectiveness of our cross-currency swaps each quarter. In the six months ended June 30, 2016 and June 30, 2015, no ineffectiveness was measured on cross-currency swaps designated as cash flow hedges.

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 "Other income (expense) – net" in the consolidated statements of income. Over the next 12 months, we expect to reclassify \$59 from accumulated OCI to interest expense due to the amortization of net losses on historical interest rate locks.

We hedge a 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. Gains and losses at the time we settle or take delivery on our designated foreign exchange contracts are amortized into income in the same period the hedged transaction affects earnings, except where an amount is deemed to be ineffective, which would be immediately reclassified to "Other income (expense) – net" in the consolidated statements of income. In the six months ended June 30, 2016 and June 30, 2015, no ineffectiveness was measured on foreign exchange contracts designated as cash flow hedges.

Collateral and Credit-Risk Contingency We have entered into agreements with our derivative counterparties establishing collateral thresholds based on respective credit ratings and netting agreements. At June 30, 2016, we had posted collateral of \$3,154 (a deposit asset) and held collateral of \$8 (a receipt liability). Under the agreements, if AT&T's credit rating had been downgraded one rating level by Fitch Ratings, before the final collateral exchange in June, we would have been required to post additional collateral of \$151. If DIRECTV Holdings LLC's credit rating had been downgraded below BBB- (S&P) and below Baa3 (Moody's), we would owe an additional \$275. At December 31, 2015, we had posted collateral of \$2,343 (a deposit asset) and held collateral of \$124 (a receipt liability). We do not offset the fair value of collateral, whether the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) exists, against the fair value of the derivative instruments.

Following are the notional amounts of our outstanding derivative positions:

June 30,

| | | December 31, |
|----------------------------|----------|-----------------|
| | 2016 | 2015 |
| Interest rate swaps | \$7,050 | \$ 7,050 |
| Cross-currency swaps | 29,642 | 29,642 |
| Foreign exchange contracts | - | 100 |
| Total | \$36,692 | \$ 36,792 |

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AT&T INC.
JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

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

Effect of Derivatives on the Consolidated Statements of Income

| | Three months ended | | Six months ended | |
|---|--------------------|---------------|------------------|---------------|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| Fair Value Hedging Relationships | | | | |
| Interest rate swaps (Interest expense): | | | | |
| Gain (Loss) on interest rate swaps | \$5 | \$(30) | \$71 | \$11 |
| Gain (Loss) on long-term debt | (5) | 30 | (71) | (11) |

In addition, the net swap settlements that accrued and settled in the quarter ended June 30 were offset against interest expense.

| | Three months ended | | Six months ended | |
|---|--------------------|---------------|------------------|---------------|
| | June 30, 2016 | June 30, 2015 | June 30, 2016 | June 30, 2015 |
| Cash Flow Hedging Relationships | | | | |
| Cross-currency swaps: | | | | |
| Gain (Loss) recognized in accumulated OCI | \$(595) | \$(102) | \$(404) | \$(330) |
| Interest rate locks: | | | | |
| Gain (Loss) recognized in accumulated OCI | - | (45) | - | (361) |
| Interest income (expense) reclassified from accumulated OCI into income | (14) | (15) | (29) | (26) |

NOTE 7. ACQUISITIONS, DISPOSITIONS AND OTHER ADJUSTMENTS

Acquisitions

DIRECTV In July 2015, we completed our acquisition of DIRECTV, a leading provider of digital television entertainment services in both the United States and Latin America. For accounting purposes, the transaction was valued at \$47,409. Our operating results include the results of DIRECTV following the acquisition date.

The fair values of the assets acquired and liabilities assumed were determined using the income, cost and market approaches. The fair value measurements were primarily based on significant inputs that are not observable in the market and are considered Level 3 under the Fair Value Measurement and Disclosure framework, other than long-term debt assumed in the acquisition (see Note 6). The income approach was primarily used to value the intangible assets, consisting of acquired customer relationships, orbital slots and trade names. The income approach estimates fair value for an asset based on the present value of cash flows projected to be generated by the asset.

Projected cash flows are discounted at a required rate of return that reflects the relative risk of achieving the cash flows and the time value of money. The cost approach, which estimates value by determining the current cost of replacing an asset with another of equivalent economic utility, was used primarily for property, plant and equipment. The cost to replace a given asset reflects the estimated reproduction or replacement cost for the property, less an allowance for loss in value due to depreciation.

Goodwill was calculated as the difference between the acquisition date fair value of the consideration transferred and the fair value of the net assets acquired, and represents the future economic benefits that we expect to achieve as a result of the acquisition.

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JUNE 30, 2016

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

The following table summarizes the fair values of the DIRECTV assets acquired and liabilities assumed and related deferred income taxes that existed as of the acquisition date.

| | |
|--|----------|
| Assets acquired | |
| Cash | \$4,797 |
| Accounts receivable | 2,038 |
| All other current assets | 1,534 |
| Property, plant and equipment | 9,320 |
| Intangible assets not subject to amortization | |
| Orbital slots | 11,946 |
| Trade name | 1,371 |
| Intangible assets subject to amortization | |
| Customer lists and relationships | 19,508 |
| Trade name | 2,915 |
| Other | 445 |
| Investments and other assets | 2,375 |
| Goodwill | 34,619 |
| Total assets acquired | 90,868 |
| Liabilities assumed | |
| Current liabilities, excluding current portion of long-term debt | 5,645 |
| Long-term debt | 20,585 |
| Other noncurrent liabilities | 16,875 |
| Total liabilities assumed | 43,105 |
| Net assets acquired | 47,763 |
| Noncontrolling interest | (354) |
| Aggregate value of consideration paid | \$47,409 |

Purchased goodwill is not expected to be deductible for tax purposes. The goodwill was allocated to our Entertainment Group and International segments.

Nextel Mexico In April 2015, we completed our acquisition of the subsidiaries of NII Holdings Inc., operating its wireless business in Mexico, for \$1,875, including approximately \$427 of net debt and other adjustments. The subsidiaries offered service under the name Nextel Mexico.

The purchase price allocation of assets acquired was: \$376 in licenses, \$1,167 in property, plant and equipment, \$128 in customer lists and \$193 of goodwill. The goodwill was allocated to our International segment.

GSF Telecom In January 2015, we acquired Mexican wireless company GSF Telecom Holdings, S.A.P.I. de C.V. (GSF Telecom) for \$2,500, including net debt of approximately \$700. GSF Telecom offered service under both the Iusacell and Unefon brand names in Mexico.

The purchase price allocation of assets acquired was: \$735 in licenses, \$658 in property, plant and equipment, \$378 in customer lists, \$26 in trade names and \$956 of goodwill. The goodwill was allocated to our International segment.

AWS-3 Auction In January 2015, we submitted winning bids of \$18,189 in the Advanced Wireless Service (AWS)-3 Auction (FCC Auction 97), a portion of which represented spectrum clearing and First Responder Network Authority funding. We provided the Federal Communications Commission (FCC) an initial down payment of \$921 in October 2014 and paid the remaining \$17,268 in the first quarter of 2015.

AT&T INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

NOTE 8. SALES OF EQUIPMENT INSTALLMENT RECEIVABLES

We offer our customers the option to purchase certain wireless devices in installments over a period of up to 30 months and, in many cases, they have the right to trade in the original equipment for a new device within a set period and have the remaining unpaid balance satisfied. As of June 30, 2016 and December 31, 2015, gross equipment installment receivables of \$4,427 and \$5,719 were included on our consolidated balance sheets, of which \$2,512 and \$3,239 are notes receivable that are included in "Accounts receivable - net."

In 2014, we entered into an uncommitted agreement pertaining to the sale of equipment installment receivables and related security with Citibank and various other relationship banks as purchasers (collectively, the Purchasers). Under this agreement, we transferred the receivables to the Purchasers for cash and additional consideration upon settlement of the receivables, referred to as the deferred purchase price. Under the terms of the agreement, we continue to bill and collect the payments from our customers on behalf of the Purchasers. To date, cash proceeds received, net of remittances (excluding amounts returned as deferred purchase price), were \$3,673.

The following table sets forth a summary of equipment installment receivables sold during the three months and six months ended June 30, 2016 and 2015:

| | Three months ended June 30, 2016 | | Six months ended June 30, 2015 | |
|-----------------------------------|---|---------|---|---------|
| Gross receivables sold | \$1,845 | \$1,728 | \$4,327 | \$4,363 |
| Net receivables sold ¹ | 1,671 | 1,555 | 3,927 | 3,936 |
| Cash proceeds received | 1,126 | 1,049 | 2,647 | 2,573 |
| Deferred purchase price recorded | 563 | 505 | 1,282 | 1,363 |

¹ Receivables net of allowance, imputed interest and trade-in right guarantees.

The deferred purchase price is initially recorded at estimated fair value, which is based on remaining installment payments expected to be collected, adjusted by the expected timing and value of device trade-ins, and subsequently carried at the lower of cost or net realizable value. The estimated value of the device trade-ins considers prices offered to us by independent third parties that contemplate changes in value after the launch of a device model. The fair value measurements used are considered Level 3 under the Fair Value Measurement and Disclosure framework (see Note 6).

During the first quarter of 2016, we repurchased equipment installment receivables previously sold to the Purchasers, with a fair value of \$532. These transactions reduced our current deferred purchase price receivable by \$539, resulting in a loss of \$7 during the first quarter. This loss is included in "Selling, general and administrative" in the consolidated statements of income.

At June 30, 2016 and December 31, 2015, our deferred purchase price receivable was \$3,426 and \$2,961, respectively, of which \$1,901 and \$1,772 is included in "Other current assets" on our consolidated balance sheets, with the remainder in "Other Assets." Our maximum exposure to loss as a result of selling these equipment installment receivables is limited to the amount of our deferred purchase price at any point in time.

The sales of equipment installment receivables did not have a material impact on our consolidated statements of income or to "Total Assets" reported on our consolidated balance sheets. We reflect the cash flows related to the arrangement as operating activities in our consolidated statements of cash flows because the cash received from the Purchasers upon both the sale of the receivables and the collection of the deferred purchase price is not subject to significant interest rate risk.

AT&T INC.
JUNE 30, 2016

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

Dollars in millions except per share and per subscriber 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 and digital entertainment services industry. Our subsidiaries and affiliates provide services and equipment that deliver voice, video and broadband services both domestically and internationally. During 2015, we completed our acquisitions of DIRECTV and wireless properties in Mexico, and the following discussion of changes in our operating revenues and expenses is affected by the timing of these acquisitions. In accordance with U.S. generally accepted accounting principles (GAAP), operating results from acquired businesses prior to acquisition are excluded. You should read this discussion in conjunction with the consolidated financial statements and accompanying notes. 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. Certain amounts have been reclassified to conform to the current period's presentation.

Consolidated Results Our financial results in the second quarter and for the first six months of 2016 and 2015 are summarized as follows:

| | Second Quarter | | | Six-Month Period | | |
|---------------------------------------|----------------|----------|----------------|------------------|----------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Operating Revenues | | | | | | |
| Service | \$37,142 | \$29,541 | 25.7 % | \$74,243 | \$58,503 | 26.9 % |
| Equipment | 3,378 | 3,474 | (2.8) | 6,812 | 7,088 | (3.9) |
| Total Operating Revenues | 40,520 | 33,015 | 22.7 | 81,055 | 65,591 | 23.6 |
| Operating expenses | | | | | | |
| Cost of services and sales | | | | | | |
| Equipment | 4,260 | 4,353 | (2.1) | 8,635 | 8,899 | (3.0) |
| Broadcast, programming and operations | 4,701 | 1,148 | - | 9,330 | 2,270 | - |
| Other cost of services | 9,514 | 9,578 | (0.7) | 18,910 | 18,390 | 2.8 |
| Selling, general and administrative | 8,909 | 7,467 | 19.3 | 17,350 | 15,428 | 12.5 |
| Depreciation and amortization | 6,576 | 4,696 | 40.0 | 13,139 | 9,274 | 41.7 |
| Total Operating Expenses | 33,960 | 27,242 | 24.7 | 67,364 | 54,261 | 24.1 |
| Operating Income | 6,560 | 5,773 | 13.6 | 13,691 | 11,330 | 20.8 |
| Income Before Income Taxes | 5,421 | 4,922 | 10.1 | 11,428 | 9,650 | 18.4 |
| Net Income | 3,515 | 3,184 | 10.4 | 7,400 | 6,523 | 13.4 |
| Net Income Attributable to AT&T | \$3,408 | \$3,082 | 10.6 % | \$7,211 | \$6,345 | 13.6 % |

Overview

Operating revenues increased \$7,505, or 22.7%, in the second quarter and \$15,464, or 23.6%, for the first six months of 2016.

Service revenues increased \$7,601, or 25.7%, in the second quarter and \$15,740, or 26.9%, for the first six months of 2016. The increases were primarily due to our 2015 acquisition of DIRECTV and increases in IP broadband and fixed strategic business services. These were partially offset by continued declines in our legacy wireline voice and data products and a true-up that increased the discounts recorded on Ethernet services. The second quarter revenues were also lower as a result of more customers choosing to purchase devices through installment payment agreements, which entitle them to lower monthly service rates under our wireless Mobile Share plans.

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Equipment revenues decreased \$96, or 2.8%, in the second quarter and \$276, or 3.9%, for the first six months of 2016. These declines reflect fewer wireless handset sales and additional promotional offers during 2016. Revenue declines were partially offset by the continuing trend of our wireless customers choosing to purchase higher priced devices and an increase in customers choosing to purchase devices on installment when compared to the prior year.

Operating expenses increased \$6,718, or 24.7%, in the second quarter and \$13,103, or 24.1%, for the first six months of 2016.

Equipment expenses decreased \$93, or 2.1%, in the second quarter and \$264, or 3.0%, for the first six months of 2016. The decreases were primarily due to the decline in devices sold to postpaid subscribers and vendor incentives, partially offset by increased sales volumes to our prepaid and international wireless customers.

Broadcast, programming and operations expenses increased \$3,553 in the second quarter and \$7,060 for the first six months of 2016 due to our acquisition of DIRECTV, slightly offset by fewer AT&T U-verse® (U-verse) subscribers.

Other cost of services expenses decreased \$64, or 0.7%, in the second quarter and increased \$520, or 2.8%, for the first six months of 2016. The decrease in the second quarter was primarily attributable to higher 2015 expenses of \$364 of network rationalization charges and merger-related expenses, combined with lower network and access charges in 2016 and our change in accounting estimate related to customer fulfillment costs (see Note 1). The decrease was mostly offset by higher expenses resulting from our acquisition of DIRECTV, higher compensation-related costs for programs tied to our stock price and an increase in noncash financing-related costs associated with our pension and postretirement benefits.

The increase for the first six months was primarily due to our acquisitions of DIRECTV and Mexican wireless properties. Also contributing to higher expenses was an increase in noncash financing-related costs associated with our pension and postretirement benefits. These increases were partially offset by prior year network rationalization charges, a decline in network and access charges and lower employee separation charges.

Selling, general and administrative expenses increased \$1,442, or 19.3%, in the second quarter and \$1,922, or 12.5%, for the first six months of 2016. The increases were primarily due to our acquisitions in 2015 and increased advertising activity in 2016, partially offset by lower wireless commission expenses. The increase for the first six months was also offset by a \$736 noncash gain on wireless spectrum transactions and lower employee separation charges.

Depreciation and amortization expense increased \$1,880, or 40.0%, in the second quarter and \$3,865, or 41.7%, for the first six months of 2016. Amortization expense increased \$1,197 in the second quarter and \$2,425 for the first six months of 2016 due to the amortization of intangibles from recent acquisitions.

Depreciation expense increased \$683, or 14.9%, in the second quarter and \$1,440, or 15.9%, for the first six months of 2016. The increase was primarily due to previously mentioned acquisitions and ongoing capital spending for network upgrades.

Operating income increased \$787, or 13.6%, in the second quarter and \$2,361, or 20.8%, for the first six months of 2016. Our operating income margin in the second quarter decreased from 17.5% in 2015 to 16.2% in 2016, and the first six months decreased from 17.3% in 2015 to 16.9% in 2016.

Interest expense increased \$326, or 35.0%, in the second quarter and \$634, or 34.6%, for the first six months of 2016. The increases were primarily due to higher average debt balances, including debt issued and debt acquired in connection with our acquisition of DIRECTV. The increase for the first six months was slightly offset by higher capitalized interest resulting from the spectrum acquired in the Advanced Wireless Service (AWS)-3 Auction (see Note 7).

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Equity in net income of affiliates decreased \$5, or 15.2%, in the second quarter and increased \$8, or 24.2%, for the first six months of 2016. Equity in net income of affiliates is primarily attributable to the results from our investments in the Game Show Network, SKY Mexico, YP Holdings LLC and Otter Media Holdings.

Other income (expense) – net We had other income of \$91 in the second quarter and \$161 for the first six months of 2016, compared to other income of \$48 in the second quarter and \$118 for the first six months of 2015. Results in the second quarter and for the first six months of 2016 included net gains on the sale of non-strategic assets and investments of \$41 and \$85 and interest and dividend income of \$38 and \$67.

Other income in the second quarter and for the first six months of 2015 included net gains on the sale of non-strategic assets and investments of \$17 and \$50 and interest and dividend income of \$26 and \$45.

Income taxes increased \$168, or 9.7%, in the second quarter and \$901, or 28.8%, for the first six months of 2016. Our effective tax rate was 35.2% for both the second quarter and first six months of 2016, as compared to 35.3% for the second quarter and 32.4% for the first six months of 2015. The increases in income tax expense for the second quarter and the first six months of 2016 were primarily due to higher income before income taxes in 2016. In 2015, we recognized tax benefits related to the restructuring of a portion of our Business Solutions segment, which contributed to lower tax expense and the effective tax rate for the first six months of 2015.

Selected Financial and Operating Data

| | June 30, | |
|--|----------|---------|
| | 2016 | 2015 |
| Subscribers and connections in (000s) | | |
| Domestic wireless subscribers | 131,805 | 123,902 |
| Mexican wireless subscribers | 9,955 | 8,550 |
| North American wireless subscribers | 141,760 | 132,452 |
| North American branded subscribers | 99,557 | 95,049 |
| North American branded net additions ¹ | 2,596 | 1,280 |
| Domestic satellite video subscribers | 20,454 | - |
| U-verse video subscribers | 4,869 | 5,971 |
| Latin America satellite video subscribers ² | 12,523 | - |
| Total video subscribers | 37,846 | 5,971 |
| Total domestic broadband connections | 15,641 | 15,961 |
| Network access lines in service | 15,285 | 18,116 |
| U-verse VoIP connections | 5,593 | 5,381 |
| Debt ratio ³ | 50.5 | % 55.5 |
| Net Debt Ratio ⁴ | 47.6 | % 45.2 |
| Ratio of earnings to fixed charges ⁵ | 4.01 | 4.18 |
| Number of AT&T employees | 277,200 | 250,730 |

¹ At June 30, 2015, our Mexican wireless subscribers have been excluded.

² Excludes subscribers of our International segment equity investments in SKY Mexico, in which we own a 41% stake. At March 31, 2016, SKY Mexico had 7.7 million subscribers.

³ Debt ratios are calculated by dividing total debt (debt maturing within one year plus long-term debt) by total capital (total debt plus total stockholders' equity) and do not consider cash available to pay down debt. See our "Liquidity and Capital Resources" section for discussion.

⁴ Net debt ratios are calculated by deriving total debt (debt maturing within one year plus long-term debt) less cash available by total capital (total debt plus total stockholders' equity).

⁵ See Exhibit 12.

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Segment Results

Our segments are strategic business units that offer different products and services over various technology platforms and/or in different geographies that are managed accordingly. Our operating segment results presented in Note 4 and discussed below for each segment follow our internal management reporting. We analyze our operating segments based on Segment Contribution, which consists of operating income, excluding acquisition-related costs and other significant items, and equity in net income (loss) of affiliate for investments managed within each operating segment. We have four reportable segments: (1) Business Solutions, (2) Entertainment Group, (3) Consumer Mobility and (4) International.

We also evaluate segment performance based on Segment Contribution, excluding equity in net income (loss) of affiliates and depreciation and amortization, which we refer to as EBITDA and/or EBITDA margin. We believe EBITDA to be a relevant and useful measurement to our investors as it is part of our internal management reporting and planning processes and it is an important metric that management uses to evaluate operating performance. EBITDA does not give effect to cash used for debt service requirements and thus does not reflect available funds for distributions, reinvestment or other discretionary uses. EBITDA margin is EBITDA divided by total revenues.

The Business Solutions segment provides services to business customers, including multinational companies; governmental and wholesale customers; and individual subscribers who purchase wireless services through employer-sponsored plans. We provide advanced IP-based services including Virtual Private Networks (VPN); Ethernet-related products and broadband, collectively referred to as strategic business services; as well as traditional data and voice products. We utilize our wireless and wired networks (referred to as "wired" or "wireline") to provide a complete communications solution to our business customers.

The Entertainment Group segment provides video, internet, voice communication, and interactive and targeted advertising services to customers located in the U.S. or in U.S. territories. We utilize our copper and IP-based wired network and/or our satellite technology.

The Consumer Mobility segment provides nationwide wireless service to consumers and wholesale and resale wireless subscribers located in the U.S. or in U.S. territories. We utilize our U.S. wireless network to provide voice and data services, including high-speed internet, video, and home monitoring services.

The International segment provides entertainment services in Latin America and wireless services in Mexico. Video entertainment services are provided to primarily residential customers using satellite technology. We utilize our regional and national wireless networks in Mexico to provide consumer and business customers with wireless data and voice communication services. Our international subsidiaries conduct business in their local currency, and operating results are converted to U.S. dollars using official exchange rates. Our International segment is subject to foreign currency fluctuations.

Our operating assets are utilized by multiple segments and consist of our wireless and wired networks as well as an international satellite fleet. We manage our assets to provide for the most efficient, effective and integrated service to our customers, not by operating segment, and therefore asset information and capital expenditures by operating segment are not presented. Depreciation is allocated based on network usage or asset utilization by segment.

We discuss capital expenditures in "Liquidity and Capital Resources."

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Business Solutions
Segment Results

| | Second Quarter | | | Six-Month Period | | | |
|------------------------------------|----------------|---------|----------------|------------------|----------|----------------|--|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change | |
| Segment operating revenues | | | | | | | |
| Wireless service | \$7,963 | \$7,756 | 2.7 % | \$15,818 | \$15,271 | 3.6 % | |
| Fixed strategic services | 2,797 | 2,580 | 8.4 | 5,559 | 5,099 | 9.0 | |
| Legacy voice and data services | 4,158 | 4,681 | (11.2) | 8,521 | 9,465 | (10.0) | |
| Other service and equipment | 886 | 854 | 3.7 | 1,744 | 1,700 | 2.6 | |
| Wireless equipment | 1,775 | 1,793 | (1.0) | 3,546 | 3,686 | (3.8) | |
| Total Segment Operating Revenues | 17,579 | 17,664 | (0.5) | 35,188 | 35,221 | (0.1) | |
| Segment operating expenses | | | | | | | |
| Operations and support | 10,857 | 10,972 | (1.0) | 21,659 | 22,045 | (1.8) | |
| Depreciation and amortization | 2,521 | 2,460 | 2.5 | 5,029 | 4,802 | 4.7 | |
| Total Segment Operating Expenses | 13,378 | 13,432 | (0.4) | 26,688 | 26,847 | (0.6) | |
| Segment Operating Income | 4,201 | 4,232 | (0.7) | 8,500 | 8,374 | 1.5 | |
| Equity in Net Income of Affiliates | - | - | - | - | - | - | |
| Segment Contribution | \$4,201 | \$4,232 | (0.7) % | \$8,500 | \$8,374 | 1.5 % | |

The following tables highlight other key measures of performance for the Business Solutions segment:

| (in 000s) | June 30, 2016 | June 30, 2015 | Percent Change | |
|-------------------------------------|---------------|---------------|----------------|--|
| Business Wireless Subscribers | | | | |
| Postpaid/Branded | 49,432 | 46,697 | 5.9 % | |
| Reseller | 52 | 19 | - | |
| Connected devices ¹ | 28,061 | 22,462 | 24.9 | |
| Total Business Wireless Subscribers | 77,545 | 69,178 | 12.1 | |
| Business IP Broadband Connections | 948 | 872 | 8.7 % | |

¹ Includes data-centric devices such as monitoring devices and automobile systems. Excludes postpaid tablets.

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| (in 000s) | Second Quarter | | | Six-Month Period | | |
|---|----------------|-------|----------------|------------------|-------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Business Wireless Net Additions ^{1,4} | | | | | | |
| Postpaid/Branded | 185 | 288 | (35.8) % | 318 | 585 | (45.6) % |
| Reseller | (13) | 3 | - | (35) | 6 | - |
| Connected devices ² | 1,199 | 1,478 | (18.9) | 2,777 | 2,502 | 11.0 |
| Business Wireless Net Subscriber Additions | 1,371 | 1,769 | (22.5) | 3,060 | 3,093 | (1.1) |
| Business Wireless Postpaid Churn ^{1,3,4} | 0.91% | 0.91% | - | 0.97% | 0.90% | 7 BP |
| Business IP Broadband Net Additions | 20 | 23 | (13.0) % | 37 | 50 | (26.0) % |

¹ Excludes migrations between AT&T segments and/or subscriber categories and acquisition-related additions during the period.

² Includes data-centric devices such as monitoring devices and automobile systems. Excludes postpaid tablets.

³ Calculated by dividing the aggregate number of wireless subscribers who canceled service during a period divided by the total number of wireless subscribers at the beginning of that period. The churn rate for the period is equal to the average of the churn rate for each month of that period.

⁴ Includes the impacts of the expected shutdown of our U.S. 2G network.

Operating Revenues decreased \$85, or 0.5%, in the second quarter and \$33, or 0.1%, for the first six months of 2016. Revenue decreases were due to continued declines in our legacy voice and data products, lower equipment revenue, the sale of certain hosting operations and foreign exchange pressures. These decreases were partially offset by increased wireless service revenues and fixed strategic services.

Wireless service revenues increased \$207, or 2.7%, in the second quarter and \$547, or 3.6%, for the first six months of 2016. The revenue increase is primarily due to customer migrations from our Consumer Mobility segment and reflects smartphone and tablet gains.

At June 30, 2016, we served 77.5 million subscribers, an increase of 12.1% from the prior year. Postpaid subscribers increased 5.9% from the prior year reflecting the addition of new customers as well as migrations from our Consumer Mobility segment, partially offset by continuing competitive pressures in the industry and losses attributable to the expected shutdown of our U.S. 2G network. Connected devices, which have lower average revenue per average subscriber (ARPU), increased 24.9% from the prior year reflecting growth in business customers using tracking, monitoring and other sensor-embedded devices on their equipment. We expect that churn and net additions of connected devices could be negatively impacted by the shutdown of the 2G network if these subscribers do not migrate to another device.

The effective management of subscriber churn is critical to our ability to maximize revenue growth and to maintain and improve margins. In the second quarter, business wireless postpaid churn was 0.91% in both 2016 and 2015, and for the first six months increased to 0.97% in 2016 from 0.90% in 2015.

Fixed strategic services revenues increased \$217, or 8.4%, in the second quarter and \$460, or 9.0%, for the first six months of 2016. Our revenues, which were negatively impacted by foreign exchange rates, increased in the second

quarter and for the first six months of 2016 due to: AT&T Dedicated Internet (formally known as Ethernet access to Managed Internet Services) of \$61 and \$115, Ethernet of \$34 and \$99, U-verse services of \$40 and \$90, and VPN of \$30 and \$56.

Legacy wired voice and data service revenues decreased \$523, or 11.2%, in the second quarter and \$944, or 10.0%, for the first six months of 2016. Traditional data revenues in the second quarter and for the first six months of 2016 decreased \$327 and \$562 and long-distance and local voice revenues decreased \$193 and \$376. The decreases were primarily due to lower demand as customers continue to migrate to fixed strategic services or shift to competitors, and the sale of certain hosting operations.

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Other service and equipment revenues increased \$32, or 3.7%, in the second quarter and \$44, or 2.6%, for the first six months of 2016. Other service revenues include project-based revenue, which is nonrecurring in nature, as well as revenues from other managed services, outsourcing, government professional service and customer premises equipment.

Wireless equipment revenues decreased \$18, or 1.0%, in the second quarter and \$140, or 3.8%, for the first six months of 2016. The decrease in equipment revenues resulted from a decrease in handsets sold to postpaid customers and increased promotional offers. The decreases were partially offset by an increase in purchases of devices on installment payment agreements rather than the device subsidy model.

Operations and support expenses decreased \$115, or 1.0%, in the second quarter and \$386, or 1.8%, for the first six months of 2016. Operations 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 compensation and benefits.

The second quarter decrease was primarily due to declines in wireless commissions costs resulting from lower sales volumes, lower amortization of customer fulfillment costs (see Note 1) and the sale of certain hosting operations. Partially offsetting these decreases were higher wireless handset insurance claims due to an increase in the volume and cost of replacement phones, advertising costs, bad debt expense driven by a higher AT&T NextSM (AT&T Next) subscriber base and wireless equipment expense.

The decrease for the first six months was primarily due to declines of \$157 in wireless equipment and \$252 in wireless commissions costs, reflecting a decrease in sales volumes. Access costs also declined \$84, largely resulting from lower interconnect costs. Lower employee-related costs and the sale of certain hosting operations also contributed to the decrease. Partially offsetting these decreases were higher advertising expenses, wireless handset insurance claims and bad debt expense driven by a higher AT&T Next subscriber base.

Depreciation expense increased \$61, or 2.5%, in the second quarter and \$227, or 4.7%, for the first six months of 2016. The increases were primarily due to ongoing capital spending for network upgrades and expansion, partially offset by fully depreciated assets.

Operating income decreased \$31, or 0.7%, in the second quarter and increased \$126, or 1.5%, for the first six months of 2016. Our Business Solutions segment operating income margin in the second quarter decreased from 24.0% in 2015 to 23.9% in 2016, and for the first six months increased from 23.8% in 2015 to 24.2% in 2016. Our Business Solutions EBITDA margin in the second quarter increased from 37.9% in 2015 to 38.2% in 2016, and for the first six months increased from 37.4% in 2015 to 38.4% in 2016.

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Entertainment Group
Segment Results

| | Second Quarter | | | Six-Month Period | | |
|---|----------------|---------|----------------|------------------|---------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Segment operating revenues | | | | | | |
| Video entertainment | \$8,963 | \$1,991 | - % | \$17,867 | \$3,862 | - % |
| High-speed internet | 1,867 | 1,623 | 15.0 | 3,670 | 3,176 | 15.6 |
| Legacy voice and data services | 1,244 | 1,516 | (17.9) | 2,557 | 3,128 | (18.3) |
| Other service and equipment | 637 | 652 | (2.3) | 1,275 | 1,276 | (0.1) |
| Total Segment Operating Revenues | 12,711 | 5,782 | - | 25,369 | 11,442 | - |
| Segment operating expenses | | | | | | |
| Operations and support | 9,569 | 4,913 | 94.8 | 19,147 | 9,772 | 95.9 |
| Depreciation and amortization | 1,489 | 1,065 | 39.8 | 2,977 | 2,130 | 39.8 |
| Total Segment Operating Expenses | 11,058 | 5,978 | 85.0 | 22,124 | 11,902 | 85.9 |
| Segment Operating Income (Loss) | 1,653 | (196) | - | 3,245 | (460) | - |
| Equity in Net Income (Loss) of Affiliates | (2) | (12) | 83.3 | 1 | (18) | - |
| Segment Contribution | \$1,651 | \$(208) | - % | \$3,246 | \$(478) | - % |

The following tables highlight other key measures of performance for the Entertainment Group segment:

| (in 000s) | June 30, 2016 | June 30, 2015 | Percent Change |
|---|---------------|---------------|----------------|
| Video Connections | | | |
| Satellite | 20,454 | - | - % |
| U-verse | 4,841 | 5,946 | (18.6) |
| Total Video Connections | 25,295 | 5,946 | - |
| Broadband Connections | | | |
| IP | 12,596 | 12,013 | 4.9 |
| DSL | 1,585 | 2,415 | (34.4) |
| Total Broadband Connections | 14,181 | 14,428 | (1.7) |
| Retail Consumer Switched Access Lines | 6,515 | 8,142 | (20.0) |
| U-verse Consumer VoIP Connections | 5,300 | 5,170 | 2.5 |
| Total Retail Consumer Voice Connections | 11,815 | 13,312 | (11.2) % |

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| (in 000s) | Second Quarter | | | Six-Month Period | | | |
|-------------------------|----------------|-------|----------------|------------------|-------|----------------|---|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change | |
| Video Net Additions | | | | | | | |
| Satellite | 342 | - | - | % 670 | - | - | % |
| U-verse | (391) | (23) | - | (773) | 26 | - | |
| Net Video Additions | (49) | (23) | - | (103) | 26 | - | |
| Broadband Net Additions | | | | | | | |
| IP | 54 | 217 | (75.1) | 240 | 630 | (61.9) | |
| DSL | (164) | (324) | 49.4 | (345) | (644) | 46.4 | |
| Net Broadband Additions | (110) | (107) | (2.8) | % (105) | (14) | - | % |

Operating revenues increased \$6,929 in the second quarter and \$13,927 for the first six months of 2016, largely due to our acquisition of DIRECTV in the third quarter of 2015. Also contributing to the increases was continued growth in consumer IP broadband, which more than offset lower revenues from legacy voice and data products.

Video entertainment revenues increased \$6,972 in the second quarter and \$14,005 for the first six months of 2016, primarily related to our acquisition of DIRECTV. We are now focusing our sales efforts on satellite service as there are lower content costs for satellite subscribers. U-verse video revenue was lower in the second quarter and the first six months of 2016, primarily due to an 18.6% decrease in U-verse video connections, when compared to 2015. At June 30, 2016, more than 80% of our video subscribers were on the DIRECTV platform.

High-speed internet revenues increased \$244, or 15.0%, in the second quarter and \$494, or 15.6%, for the first six months of 2016. When compared to 2015, IP broadband subscribers increased 4.9%, to 12.6 million subscribers at June 30, 2016; however, second-quarter and year-to-date net additions were lower due to fewer U-verse sales promotions in the year. The churn of video customers also contributed to lower net additions, as a portion of these video subscribers also chose to disconnect their IP broadband service.

Legacy voice and data service revenues decreased \$272, or 17.9%, in the second quarter and \$571, or 18.3%, for the first six months of 2016. At June 30, 2016, legacy voice and data services represented approximately 10% of our total Entertainment Group revenue, and reflect decreases of \$161 and \$340 in long-distance, and \$111 and \$231 in traditional data revenues. The decreases reflect the continued migration of customers to our more advanced IP-based offerings or to competitors. At June 30, 2016, approximately 11% of our broadband connections were DSL compared to nearly 17% at June 30, 2015.

Operations and support expenses increased \$4,656, or 94.8%, in the second quarter and \$9,375, or 95.9%, for the first six months of 2016. Operations and support expenses consist of costs incurred to provide our products and services, including costs of operating and maintaining our networks and providing video content, as well as personnel charges for compensation and benefits.

Increased expenses were primarily due to our acquisition of DIRECTV, which increased our second quarter and year-to-date Entertainment Group expenses by \$5,100 and \$9,923. The DIRECTV related second quarter and year-to-date increases were primarily due to the recognition of additional content costs for satellite subscribers, customer support and service related charges and advertising expenses. Partially offsetting these increases were lower

employee charges resulting from ongoing workforce reductions and our focus on cost initiatives.

Depreciation expenses increased \$424, or 39.8%, in the second quarter and \$847, or 39.8%, for the first six months of 2016. The increases were primarily due to our acquisition of DIRECTV and ongoing capital spending for network upgrades and expansion, partially offset by fully depreciated assets.

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Operating income increased \$1,849 in the second quarter and \$3,705 for the first six months of 2016. Our Entertainment Group segment operating income margin in the second quarter increased from (3.4)% in 2015 to 13.0% in 2016, and for the first six months increased from (4.0)% in 2015 to 12.8% in 2016. Our Entertainment Group segment EBITDA margin in the second quarter increased from 15.0% in 2015 to 24.7% in 2016, and the first six months increased from 14.6% in 2015 to 24.5% in 2016.

Consumer Mobility
Segment Results

| | Second Quarter | | | Six-Month Period | | |
|--|----------------|---------|----------------|------------------|----------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Segment operating revenues | | | | | | |
| Service | \$6,948 | \$7,359 | (5.6) % | \$13,891 | \$14,656 | (5.2) % |
| Equipment | 1,238 | 1,396 | (11.3) | 2,623 | 2,877 | (8.8) |
| Total Segment Operating Revenues | 8,186 | 8,755 | (6.5) | 16,514 | 17,533 | (5.8) |
| Segment operating expenses | | | | | | |
| Operations and support | 4,680 | 5,202 | (10.0) | 9,592 | 10,743 | (10.7) |
| Depreciation and amortization | 932 | 934 | (0.2) | 1,854 | 1,936 | (4.2) |
| Total Segment Operating Expenses | 5,612 | 6,136 | (8.5) | 11,446 | 12,679 | (9.7) |
| Segment Operating Income | 2,574 | 2,619 | (1.7) | 5,068 | 4,854 | 4.4 |
| Equity in Net Income (Loss) of Affiliates | - | - | - | - | - | - |
| Segment Contribution | \$2,574 | \$2,619 | (1.7) % | \$5,068 | \$4,854 | 4.4 % |

The following tables highlight other key measures of performance for the Consumer Mobility segment:

| (in 000s) | June 30, 2016 | June 30, 2015 | Percent Change |
|-------------------------------------|---------------|---------------|----------------|
| Consumer Mobility Subscribers | | | |
| Postpaid | 27,862 | 29,844 | (6.6) % |
| Prepaid | 12,633 | 10,438 | 21.0 |
| Branded | 40,495 | 40,282 | 0.5 |
| Reseller | 12,869 | 13,487 | (4.6) |
| Connected devices ¹ | 896 | 955 | (6.2) |
| Total Consumer Mobility Subscribers | 54,260 | 54,724 | (0.8) % |

¹ Includes data-centric devices such as session-based tablets, monitoring devices and automobile systems. Excludes postpaid tablets.

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| (in 000s) | Second Quarter | | | Six-Month Period | | |
|---|----------------|-------|----------------|------------------|-------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Consumer Mobility Net Additions ^{1, 4} | | | | | | |
| Postpaid | 72 | 122 | (41.0) % | 68 | 266 | (74.4) % |
| Prepaid | 365 | 331 | 10.3 | 865 | 429 | - |
| Branded Net Additions | 437 | 453 | (3.5) | 933 | 695 | 34.2 |
| Reseller | (446) | (98) | - | (824) | (367) | - |
| Connected devices ² | (1) | (30) | 96.7 | (27) | (109) | 75.2 |
| Consumer Mobility Net Subscriber Additions | (10) | 325 | - % | 82 | 219 | (62.6) % |
| | | | | | | |
| Total Churn ^{1, 3, 4} | 1.96% | 1.86% | 10 BP | 2.04% | 1.95% | 9 BP |
| Postpaid Churn ^{1, 3, 4} | 1.09% | 1.16% | (7) BP | 1.16% | 1.18% | (2) BP |

¹ Excludes migrations between AT&T segments and/or subscriber categories and acquisition-related additions during the period.

² Includes data-centric devices such as session-based tablets, monitoring devices and automobile systems. Excludes postpaid tablets.

³ Calculated by dividing the aggregate number of wireless subscribers who canceled service during a period divided by the total number of wireless subscribers at the beginning of that period. The churn rate for the period is equal to the average of the churn rate for each month of that period.

⁴ Includes the impacts of the expected shutdown of our U.S. 2G network.

Operating Revenues decreased \$569, or 6.5%, in the second quarter and \$1,019, or 5.8%, for the first six months of 2016. Decreased revenues reflect declines in postpaid service revenues due to customers choosing Mobile Share plans and migrating to our Business Solutions segment, partially offset by higher prepaid service revenues. Our business wireless offerings allow for individual subscribers to purchase wireless services through employer-sponsored plans for a reduced price. The migration of these subscribers to the Business Solutions segment negatively impacted our consumer postpaid subscriber total and service revenue growth.

Service revenue decreased \$411, or 5.6%, in the second quarter and \$765, or 5.2%, for the first six months of 2016. The decreases were largely due to postpaid customers continuing to shift to no-device-subsidy plans that allow for discounted monthly service charges under our Mobile Share plans, and the migration of subscribers to Business Solutions. Revenues from postpaid customers declined \$627, or 11.1%, in the second quarter and \$1,143, or 10.2%, for the first six months. Without the migration of customers to Business Solutions, postpaid wireless revenues would have decreased approximately 6.2% and 5.2%, respectively. The decreases were partially offset by higher prepaid service revenues of \$249 in the second quarter and \$453 for the first six months and include services sold under the Cricket brand.

Equipment revenue decreased \$158, or 11.3%, in the second quarter and \$254, or 8.8%, for the first six months of 2016. The decreases in equipment revenues resulted from lower postpaid handset volumes and increased promotional activities, partially offset by increases in handsets sold to prepaid customers and devices purchased on installment payment agreements rather than the device subsidy model.

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Operations and support expenses decreased \$522, or 10.0%, in the second quarter and \$1,151, or 10.7%, for the first six months of 2016. Operations and support expenses consist of costs incurred to provide our products and services, including costs of operating and maintaining our networks and personnel expenses, such as compensation and benefits.

Decreased operations and support expenses in the second quarter were primarily due to the following:

- Equipment costs decreased \$223 primarily due to lower postpaid handset volumes partially offset by the sale of more devices to prepaid subscribers.
- Selling and commission expenses decreased \$113 primarily due to lower sales volumes and lower average commission rates, including those paid under the AT&T Next program, combined with fewer upgrade transactions.
- Network costs decreased \$81 primarily due to lower interconnect costs resulting from our ongoing network transition to more efficient Ethernet/IP-based technologies.
- Customer service costs decreased \$69 primarily due to reduced salaries and benefits and lower vendor and professional services from reduced call volumes.

Decreased operations and support expenses for the first six months were primarily due to the following:

- Equipment costs decreased \$343 primarily due to lower postpaid handset volumes partially offset by the sale of more devices to prepaid subscribers.
- Selling and commission expenses decreased \$318 primarily due to lower sales volumes and lower average commission rates, including those paid under the AT&T Next program, combined with fewer upgrade transactions.
- Network costs decreased \$196 primarily due to lower interconnect costs resulting from our ongoing network transition to more efficient Ethernet/IP-based technologies.
- Customer service costs decreased \$113 primarily due to reduced salaries and benefits and lower vendor and professional services from reduced call volumes.

Depreciation expense decreased \$2, or 0.2%, in the second quarter and \$82, or 4.2%, for the first six months of 2016. The decrease was primarily due to fully depreciated assets, partially offset by the ongoing capital spending for network upgrades and expansion.

Operating income decreased \$45, or 1.7%, in the second quarter and increased \$214, or 4.4%, in the first six months of 2016. Our Consumer Mobility segment operating income margin in the second quarter increased from 29.9% in 2015 to 31.4% in 2016, and for the first six months increased from 27.7% in 2015 to 30.7% in 2016. Our Consumer Mobility EBITDA margin in the second quarter increased from 40.6% in 2015 to 42.8% in 2016, and for the first six months increased from 38.7% in 2015 to 41.9% in 2016.

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International
Segment Results

| | Second Quarter | | | Six-Month Period | | |
|------------------------------------|----------------|---------|----------------|------------------|---------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Segment operating revenues | | | | | | |
| Video entertainment | \$1,222 | \$- | - % | \$2,352 | \$- | - % |
| Wireless | 489 | 444 | 10.1 | 944 | 659 | 43.2 |
| Equipment | 117 | 47 | - | 199 | 68 | - |
| Total Segment Operating Revenues | \$1,828 | \$491 | - | \$3,495 | \$727 | - |
| Segment operating expenses | | | | | | |
| Operations and support | \$1,723 | \$529 | - | \$3,311 | \$747 | - |
| Depreciation and amortization | 298 | 93 | - | 575 | 121 | - |
| Total Segment Operating Expenses | 2,021 | 622 | - | 3,886 | 868 | - |
| Segment Operating Income (Loss) | (193) | (131) | (47.3) | (391) | (141) | - |
| Equity in Net Income of Affiliates | 9 | - | - | 23 | - | - |
| Segment Contribution | \$(184) | \$(131) | (40.5) % | \$(368) | \$(141) | - % |

The following tables highlight other key measures of performance for the International segment:

| (in 000s) | June 30, 2016 | June 30, 2015 | Percent Change |
|--|---------------|---------------|----------------|
| Mexican Wireless Subscribers | | | |
| Postpaid | 4,570 | 4,144 | 10.3 % |
| Prepaid | 5,059 | 3,926 | 28.9 |
| Branded | 9,629 | 8,070 | 19.3 |
| Reseller | 326 | 480 | (32.1) |
| Total Mexican Wireless Subscribers | 9,955 | 8,550 | 16.4 |
| Latin America Satellite Subscribers | | | |
| PanAmericana | 7,175 | - | - |
| SKY Brazil | 5,348 | - | - |
| Total Latin America Satellite Subscribers ¹ | 12,523 | - | - % |

¹ Excludes subscribers of our International segment equity investments in SKY Mexico, in which we own a 41% stake. At March 31, 2016, SKY Mexico had 7.7 million subscribers.

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| (in 000s) | Second Quarter | | | Six-Month Period | | |
|---------------------------------------|----------------|-------|----------------|------------------|-------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Mexican Wireless Net Additions | | | | | | |
| Postpaid | 165 | 2 | - % | 281 | 32 | - % |
| Prepaid | 614 | (161) | - | 1,064 | (467) | - |
| Branded Net Additions | 779 | (159) | - | 1,345 | (435) | - |
| Reseller | (37) | (11) | - | (74) | (23) | - |
| Mexican Wireless | | | | | | |
| Net Subscriber Additions | 742 | (170) | - | 1,271 | (458) | - |
| Latin America Satellite Net Additions | | | | | | |
| PanAmericana | 81 | - | - | 109 | - | - |
| SKY Brazil | 6 | - | - | (95) | - | - |
| Latin America Satellite | | | | | | |
| Net Subscriber Additions ¹ | 87 | - | - % | 14 | - | - % |

¹ Excludes subscribers of our International segment equity investments in SKY Mexico, in which we own a 41% stake. At March 31, 2016, SKY Mexico had 7.7 million subscribers and net subscriber additions of 398,000 in the first quarter of 2016.

Operating Results

Our International segment consists of the Latin American operations acquired in our July 2015 acquisition of DIRECTV as well as the Mexican wireless operations acquired earlier in 2015 (see Note 7). Video entertainment services are provided to primarily residential customers using satellite technology. Our international subsidiaries conduct business in their local currency and operating results are converted to U.S. dollars using official exchange rates. Our International segment is subject to foreign currency fluctuations.

Operating revenues increased \$1,337 in the second quarter and \$2,768 for the first six months of 2016. The increase in the second quarter and for the first six months includes \$1,222 and \$2,352 from video services in Latin America and increases of \$115 and \$416 attributable to additional wireless revenues in Mexico.

Operations and support expenses increased \$1,194 in the second quarter and \$2,564 for the first six months of 2016. Operations and support expenses consist of costs incurred to provide our products and services, including costs of operating and maintaining our networks and providing video content and personnel expenses, such as compensation and benefits.

Depreciation expense increased \$205 in the second quarter and \$454 for the first six months of 2016. The increase was primarily due to the acquisition of DIRECTV.

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Operating income decreased \$62 in the second quarter and \$250 for the first six months of 2016. Our International segment operating income margin in the second quarter was (10.6)% in 2016 and (26.7)% in 2015, and for the first six months was (11.2)% in 2016 and (19.4)% in 2015. Our International EBITDA margin in the second quarter was 5.7% in 2016 and (7.7)% in 2015 and the first six months was 5.3% in 2016 and (2.8)% for 2015.

Supplemental Operating Information

As a supplemental discussion of our operating results, for comparison purposes, we are providing a view of our combined domestic wireless operations (AT&T Mobility).

AT&T Mobility Results

| | Second Quarter | | | Six-Month Period | | |
|-------------------------------|----------------|----------|----------------|------------------|----------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Operating revenues | | | | | | |
| Service | \$14,912 | \$15,115 | (1.3) % | \$29,710 | \$29,927 | (0.7) % |
| Equipment | 3,013 | 3,189 | (5.5) | 6,169 | 6,563 | (6.0) |
| Total Operating Revenues | 17,925 | 18,304 | (2.1) | 35,879 | 36,490 | (1.7) |
| Operating expenses | | | | | | |
| Operations and support | 10,502 | 10,973 | (4.3) | 21,126 | 22,445 | (5.9) |
| EBITDA | 7,423 | 7,331 | 1.3 | 14,753 | 14,045 | 5.0 |
| Depreciation and amortization | 2,081 | 2,031 | 2.5 | 4,137 | 4,036 | 2.5 |
| Total Operating Expenses | 12,583 | 13,004 | (3.2) | 25,263 | 26,481 | (4.6) |
| Operating Income | \$5,342 | \$5,300 | 0.8 % | \$10,616 | \$10,009 | 6.1 % |

The following tables highlight other key measures of performance for AT&T Mobility:

| (in 000s) | June 30, 2016 | June 30, 2015 | Percent Change |
|--|---------------|---------------|----------------|
| Wireless Subscribers ¹ | | | |
| Postpaid smartphones | 58,508 | 57,536 | 1.7 % |
| Postpaid feature phones and data-centric devices | 18,787 | 19,005 | (1.1) |
| Postpaid | 77,295 | 76,541 | 1.0 |
| Prepaid | 12,633 | 10,438 | 21.0 |
| Branded | 89,928 | 86,979 | 3.4 |
| Reseller | 12,920 | 13,506 | (4.3) |
| Connected devices ² | 28,957 | 23,417 | 23.7 |
| Total Wireless Subscribers | 131,805 | 123,902 | 6.4 |
| Branded Smartphones | 69,058 | 65,243 | 5.8 |
| Mobile Share connections | 58,246 | 57,813 | 0.7 |
| Smartphones under our installment program at end of period | 29,026 | 21,106 | 37.5 % |

¹ Represents 100% of AT&T Mobility wireless subscribers.

² Includes data-centric devices such as session-based tablets, monitoring devices and automobile systems. Excludes postpaid tablets.

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| (in 000s) | Second Quarter | | | Six-Month Period | | |
|--|----------------|-------|----------------|------------------|-------|----------------|
| | 2016 | 2015 | Percent Change | 2016 | 2015 | Percent Change |
| Wireless Net Additions ^{1,4} | | | | | | |
| Postpaid | 257 | 410 | (37.3) % | 386 | 851 | (54.6) % |
| Prepaid | 365 | 331 | 10.3 | 865 | 429 | - |
| Branded Net Additions | 622 | 741 | (16.1) | 1,251 | 1,280 | (2.3) |
| Reseller | (459) | (95) | - | (859) | (361) | - |
| Connected devices ² | 1,198 | 1,448 | (17.3) | 2,750 | 2,393 | 14.9 |
| Wireless Net Subscriber Additions | 1,361 | 2,094 | (35.0) | 3,142 | 3,312 | (5.1) |
| Smartphones sold under our installment program during period | 3,960 | 3,859 | 2.6 | 8,095 | 7,924 | 2.2 |
| Total Churn ^{3,4} | 1.35% | 1.31% | 4 BP | 1.38% | 1.36% | 2 BP |
| Branded Churn ^{3,4} | 1.47% | 1.52% | (5) BP | 1.55% | 1.55% | - |
| Postpaid Churn ^{3,4} | 0.97% | 1.01% | (4) BP | 1.04% | 1.01% | 3 BP |

¹ Excludes acquisition-related additions during the period.

² Includes data-centric devices such as session-based tablets, monitoring devices and automobile systems. Excludes postpaid tablets.

³ Calculated by dividing the aggregate number of wireless subscribers who canceled service during a period divided by the total number of wireless subscribers at the beginning of that period. The churn rate for the period is equal to the average of the churn rate for each month of that period.

⁴ Includes the impacts of the expected shutdown of our U.S. 2G network.

Operating income increased \$42, or 0.8%, in the second quarter and \$607, or 6.1%, for the first six months of 2016. The operating income margin of AT&T Mobility in the second quarter increased from 29.0% in 2015 to 29.8% in 2016, and increased for the first six months from 27.4% in 2015 to 29.6% in 2016. AT&T Mobility's EBITDA margin in the second quarter increased from 40.1% in 2015 to 41.4% in 2016, and increased for the first six months from 38.5% in 2015 to 41.1% in 2016. AT&T Mobility's EBITDA service margin in the second quarter increased from 48.5% in 2015 to 49.8% in 2016, and increased for the first six months from 46.9% in 2015 to 49.7% in 2016. (EBITDA service margin is operating income before depreciation and amortization, divided by total service revenues.)

Subscriber Relationships

As the wireless industry continues to mature, we believe that future wireless growth will increasingly depend on our ability to offer innovative services, plans and devices and a wireless network that has sufficient spectrum and capacity to support these innovations on as broad a geographic basis as possible. To attract and retain subscribers in a maturing market, we have launched a wide variety of plans, including Mobile Share and AT&T Next. Additionally, beginning in the first quarter of 2016, we introduced an integrated offer that allows for unlimited wireless data when combined with our video services, ending the second quarter with more than 5.0 million subscribers on these packages.

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The expected year-end 2016 shutdown of our U.S. 2G network is beginning to contribute to higher disconnections and churn of subscribers. We expect that churn and net additions could be negatively impacted by the shutdown of this network if these subscribers do not choose to migrate to another device. Our 2G subscribers and connections at June 30 are as follows:

| | June 30, 2016 | June 30, 2015 | Percent Change |
|--------------------------------------|---------------------|---------------------|-------------------|
| (in 000s) | | | |
| Postpaid (primarily phones) | 626 | 1,252 | (50.0) % |
| Prepaid | 254 | 405 | (37.3) |
| Reseller ¹ | 1,287 | 3,768 | (65.8) |
| Connected devices ² | 3,983 | 7,449 | (46.5) |
| Total 2G Subscribers and Connections | 6,150 | 12,874 | (52.2) % |

¹ Primarily included in our Consumer Mobility segment.

² Primarily included in our Business Solutions segment.

ARPU

Postpaid phone-only ARPU (average revenue per average wireless subscriber) was \$59.80 for the second quarter and \$59.66 for the first six months of 2016, compared to \$61.26 and \$60.62 in 2015. Postpaid phone-only ARPU plus AT&T Next subscriber installment billings increased 2.5% compared to the second quarter of 2015 and 3.8% compared to the first six months of 2015 due to the continuing growth of the AT&T Next program.

Churn

The effective management of subscriber churn is critical to our ability to maximize revenue growth and to maintain and improve margins. Total churn was higher for the second quarter and first six months of 2016, but could be negatively impacted in the future by the loss of 2G reseller subscribers and connected devices on our 2G network. While postpaid churn was lower in the second quarter, it was higher for the six months, reflecting continuing competitive pressure in the industry.

Branded Subscribers

Branded subscribers increased 0.7% when compared to March 31, 2016 and 3.4% when compared to June 30, 2015. These increases included a 3.8% and 21.0% increase in prepaid subscribers and a 0.2% and 1.0% increase in postpaid subscribers, respectively. At June 30, 2016, 89% of our postpaid phone subscriber base used smartphones, compared to 85% at June 30, 2015. Virtually all of our postpaid smartphone subscribers are on plans that provide for service on multiple devices at reduced rates, and such subscribers tend to have higher retention and lower churn rates. Device connections on our Mobile Share plans now represent 75% of our postpaid customer base. Such offerings are intended to encourage existing subscribers to upgrade their current services and/or add connected devices, attract new subscribers from other providers and minimize churn.

During the first quarter of 2016, we discontinued offering subsidized smartphones to most of our customers. Under this no-subsidy model, subscribers must purchase a device on installments under an equipment installment program or choose to bring their own device, with no annual service contract. At June 30, 2016, about 50% of the postpaid smartphone base is on an installment program compared to nearly 37% at June 30, 2015. Of the postpaid smartphone gross adds and upgrades during the second quarter and first six months of 2016, 93% and 92% were either equipment installment plans or BYOD. While BYOD customers do not generate equipment revenue or expense, the service

revenue helps improve our margins. During the second quarter and first six months of 2016, we added approximately 477,000 and 1,033,000 BYOD customers, compared to 334,000 and 647,000 in 2015.

Our equipment installment purchase programs, including AT&T Next, allow for postpaid subscribers to purchase certain devices in installments over a period of up to 30 months. Additionally, after a specified period of time, AT&T Next subscribers also have the right to trade in the original device for a new device with a new installment plan and have the remaining unpaid balance satisfied. For installment programs, we recognize equipment revenue at the time of the sale for the amount of the customer receivable, net of the fair value of the trade-in right guarantee and imputed interest. A significant percentage of our customers choosing equipment installment programs pay a lower monthly service charge, which results in lower service revenue recorded for these subscribers.

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Connected Devices

Connected Devices includes data-centric devices such as session-based tablets, monitoring devices and automobile systems. Connected device subscribers increased 4.3% during the second quarter when compared to March 31, 2016 and 23.7% when compared to June 30, 2015. During the second quarter and first six months of 2016, we added approximately 1.3 million and 2.4 million "connected" cars through agreements with various carmakers. We believe that these connected car agreements give us the opportunity to create future retail relationships with the car owners.

OTHER BUSINESS MATTERS

Litigation Challenging DIRECTV's NFL Sunday Ticket More than two dozen putative class actions were filed in the U.S. District Courts for the Central District of California and the Southern District of New York against DIRECTV and the National Football League (NFL). These cases were brought by residential and commercial DIRECTV subscribers that have purchased NFL Sunday Ticket. The plaintiffs allege that (i) the 32 NFL teams have unlawfully agreed not to compete with each other in the market for nationally televised NFL football games and instead have "pooled" their broadcasts and assigned to the NFL the exclusive right to market them; and (ii) the NFL and DIRECTV have entered into an unlawful exclusive distribution agreement that allows DIRECTV to charge "supra-competitive" prices for the NFL Sunday Ticket package. The complaints seek unspecified treble damages and attorneys' fees along with injunctive relief. The first complaint, *Abrahamian v. National Football League, Inc., et al.*, was served in June 2015. In December 2015, the Judicial Panel on Multidistrict Litigation transferred the cases outside the Central District of California to that court for consolidation and management of pre-trial proceedings. On June 24, 2016, the plaintiffs filed a consolidated amended complaint. We vigorously dispute the allegations the complaints have asserted.

Federal Trade Commission Litigation Involving DIRECTV In March 2015, the Federal Trade Commission (FTC) filed a civil suit in the U.S. District Court for the Northern District of California against DIRECTV seeking injunctive relief and unspecified money damages under Section 5 of the Federal Trade Commission Act and Section 4 of the Restore Online Shoppers' Confidence Act. The FTC's allegations concern DIRECTV's advertising, marketing and sale of programming packages. The FTC alleges that DIRECTV did not adequately disclose all relevant terms. We are disputing these allegations vigorously.

Unlimited Data Plan Claims In October 2014, the FTC filed a civil suit in the U.S. District Court for the Northern District of California against AT&T Mobility, LLC seeking injunctive relief and unspecified money damages under Section 5 of the Federal Trade Commission Act. The FTC's allegations concern the application of AT&T's Maximum Bit Rate (MBR) program to customers who enrolled in our Unlimited Data Plan from 2007-2010. MBR temporarily reduces in certain instances the download speeds of a small portion of our legacy Unlimited Data Plan customers each month after the customer exceeds a designated amount of data during the customer's billing cycle. MBR is an industry-standard practice that is designed to affect only the most data-intensive applications (such as video streaming). Texts, emails, tweets, social media posts, internet browsing and many other applications are typically unaffected. Contrary to the FTC's allegations, which we vigorously dispute, our MBR program is permitted by our customer contracts, was fully disclosed in advance to our Unlimited Data Plan customers, and was implemented to protect the network for the benefit of all customers. In March 2015, our motion to dismiss the litigation on the grounds that the FTC lacked jurisdiction to file suit was denied. In May 2015, the Court granted our motion to certify its decision for immediate appeal. The United States Court of Appeals for the Ninth Circuit subsequently granted our petition to accept the appeal, and the appeal is now pending before that Court while limited discovery proceeds in the District Court. Oral argument on the appeal was heard on June 17, 2016, and we are now waiting for the appellate court to issue its decision. In addition to the FTC case, several class actions have been filed also challenging our MBR

program. We vigorously dispute the allegations the complaints have asserted.

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In June 2015, the Federal Communications Commission (FCC) issued a Notice of Apparent Liability and Order (NAL) to AT&T Mobility, LLC concerning our MBR policy that applies to Unlimited Data Plan customers described above. The NAL alleges that we violated the FCC's Open Internet Transparency Rule by using the term "unlimited" in connection with the offerings subject to the MBR policy and by failing adequately to disclose the speed reductions that apply once a customer reaches a specified data threshold. The NAL proposes a forfeiture penalty of \$100, and further proposes to order us to correct any misleading and inaccurate statements about our unlimited plans, inform customers of the alleged violation, revise our disclosures to address the alleged violation and inform these customers that they may cancel their plans without penalty after reviewing the revised disclosures. In July 2015, we filed our response to the NAL. We believe that the NAL is unlawful and should be withdrawn, because we have fully complied with the Open Internet Transparency Rule and the FCC has no authority to impose the proposed remedies. The matter is currently pending before the FCC.

Labor Contracts A contract covering approximately 9,000 mobility employees in the Southwest region, which expired in February 2016, was ratified on April 14, 2016. A contract covering nearly 16,000 traditional wireline employees in our West region expired in April 2016 and employees are working under the terms of the prior contract, including benefits, while negotiations continue. After expiration of the current agreements, work stoppages or labor disruptions may occur in the absence of new contracts or other agreements being reached.

For our U.S. mobility employees, contracts covering wages and other non-benefit working terms are structured on a regional basis, with a separate national contract primarily covering medical benefits. Approximately 40,000 employees are covered in this separate contract that has a no strike/no lock-out clause. On August 3, 2016, we reached a tentative agreement on this contract that was due to expire on December 31, 2016.

COMPETITIVE AND REGULATORY ENVIRONMENT

Overview AT&T subsidiaries operating within the United States are subject to federal and state regulatory authorities. AT&T subsidiaries operating outside the United States are subject to the jurisdiction of national and supranational regulatory authorities in the markets where service is provided.

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 or expanded certain regulatory requirements that were imposed decades ago on our traditional wireline subsidiaries when they operated as legal monopolies. We are pursuing, at both the state and federal levels, additional legislative and regulatory measures to reduce regulatory burdens that are no longer appropriate in a competitive telecommunications market and that inhibit our ability to compete more effectively and offer services wanted and needed by our customers, including initiatives to transition services from traditional networks to all IP-based networks. At the same time, we also seek to ensure that legacy regulations are not further extended to broadband or wireless services, which are subject to vigorous competition.

In February 2015, the FCC released an order reclassifying both fixed and mobile consumer broadband internet access services as telecommunications services, subject to comprehensive regulation under the Telecom Act. The FCC's decision significantly expands the FCC's existing authority to regulate the provision of fixed and mobile broadband internet access services. AT&T and other providers of broadband internet access services challenged the FCC's

decision before the U.S. Court of Appeals for the D.C. Circuit. On June 14, 2016, a panel of the Court of Appeals upheld the FCC's rules by a 2-1 vote. On July 29, 2016, AT&T and several of the other parties that challenged the rules filed petitions with the Court of Appeals asking that the case be reheard either by the panel or by the full Court. Those petitions remain pending.

The FCC is in the process of adopting new rules that could restrict our commercial flexibility in the provision of video, special access, business and advertising services. New rules are expected before the end of 2016. If new rules are adopted, we expect to appeal any rule that we believe to restrain on our business unlawfully.

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We provide satellite video service through our subsidiary DIRECTV, whose satellites are licensed by the FCC. The Communications Act of 1934 and other related acts give the FCC broad authority to regulate the U.S. operations of DIRECTV. In addition, states representing a majority of our local service access lines have adopted legislation that enables us to provide U-verse service through a single statewide or state-approved franchise (as opposed to the need to acquire hundreds or even thousands of municipal-approved franchises) to offer a competitive video product. We also are supporting efforts to update and improve regulatory treatment for retail services. Regulatory reform and passage of legislation is uncertain and depends on many factors.

We provide wireless services in robustly competitive markets, but are subject to substantial and increasing governmental regulation. Wireless communications providers must obtain licenses from the FCC to provide communications services at specified spectrum frequencies within specified geographic areas and must comply with the FCC rules and policies governing the use of the spectrum. While wireless communications providers' prices and offerings are generally not subject to state regulation, states sometimes attempt to regulate or legislate various aspects of wireless services, such as in the area of consumer protection.

The FCC has recognized that the explosive growth of bandwidth-intensive wireless data services requires the U.S. Government to make more spectrum available. In February 2012, Congress set forth specific spectrum blocks to be auctioned and licensed by February 2015 (the "AWS-3 Auction") and also authorized the FCC to conduct an "incentive auction," to make available for wireless broadband use certain spectrum that is currently used by broadcast television licensees (the "600 MHz Auction"). We participated in the AWS-3 Auction. The 600 MHz Auction (Auction 1000) began on March 29, 2016, and the multiple phases of Auction 1000 are expected to progress over the next several months.

We have also submitted a bid to provide a nationwide mobile broadband network for first responders (FirstNet). Should our bid be accepted, the actual reach of the network will depend on participation by the individual States.

In May 2014, in a separate proceeding, the FCC issued an order revising its policies governing mobile spectrum holdings. The FCC rejected the imposition of caps on the amount of spectrum any carrier could acquire, retaining its case-by-case review policy. Moreover, it increased the amount of spectrum that could be acquired before exceeding an aggregation "screen" that would automatically trigger closer scrutiny of a proposed transaction. On the other hand, it indicated that it will separately consider an acquisition of "low band" spectrum that exceeds one-third of the available low band spectrum as presumptively harmful to competition. In addition, the FCC imposed limits on certain bidders in the 600 MHz Auction, including AT&T, restricting them from bidding on up to 40 percent of the available spectrum in markets that cover as much as 70-80 percent of the U.S. population. On balance, the order and the new spectrum screen should allow AT&T to obtain additional spectrum to meet our customers' needs, but because AT&T uses more "low band" spectrum in its network than some other national carriers, the separate consideration of low band spectrum acquisitions might affect AT&T's ability to expand capacity in these bands (low band spectrum has better propagation characteristics than "high band" spectrum). We seek to ensure that we have the opportunity, through the auction process and otherwise, to obtain the spectrum we need to provide our customers with high-quality service in the future.

As the wireless industry continues to mature, we believe that future wireless growth will increasingly depend on our ability to offer innovative video and data services and a wireless network that has sufficient spectrum and capacity to support these innovations. We continue to face spectrum and capacity constraints on our wireless network in certain markets. We expect such constraints to increase and expand to additional markets in the coming years. While we are continuing to invest significant capital in expanding our network capacity, our capacity constraints could affect the

quality of existing voice and data services and our ability to launch new, advanced wireless broadband services, unless we are able to obtain more spectrum. Any long-term spectrum solution will require that the FCC make additional spectrum available to the wireless industry to meet the expanding needs of our subscribers. We will continue to attempt to address spectrum and capacity constraints on a market-by-market basis.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Continued
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LIQUIDITY AND CAPITAL RESOURCES

We had \$7,208 in cash and cash equivalents available at June 30, 2016. Cash and cash equivalents included cash of \$2,408 and money market funds and other cash equivalents of \$4,800. Approximately \$600 of our cash and cash equivalents resided in foreign jurisdictions, some of which are subject to restrictions on repatriation. Cash and cash equivalents increased \$2,087 since December 31, 2015. In the first six months of 2016, cash inflows were primarily provided by cash receipts from operations, including cash from our sale and transfer of certain wireless equipment installment receivables to third parties, and long-term debt issuances. 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; debt repayments; dividends to stockholders; and the acquisition of wireless spectrum and other operations. We discuss many of these factors in detail below.

Cash Provided by or Used in Operating Activities

During the first six months of 2016, cash provided by operating activities was \$18,207, compared to \$15,898 for the first six months of 2015. Higher operating cash flows in 2016 were primarily due to our acquisition of DIRECTV offset by the timing of working capital payments.

Cash Used in or Provided by Investing Activities

For the first six months of 2016, cash used in investing activities totaled \$10,017 and consisted primarily of \$9,702 for capital expenditures, excluding interest during construction, and \$485 for the acquisition of wireless spectrum, Quickplay Media, Inc. and other operations. These expenditures were partially offset by net cash receipts of \$500 from the sale of securities.

Virtually all of our capital expenditures are spent on our wireless and wireline networks, our video services and related support systems. Capital expenditures, excluding interest during construction, increased \$1,374 in the first six months. The increase was primarily due to our wireless network expansion in Mexico, DIRECTV operations and continued fiber buildout. In connection with capital improvements to our wireless network in Mexico, we also negotiated favorable payment terms (referred to as vendor financing). For the first six months of 2016, we excluded \$138 of vendor financing related to capital investments. We do not report capital expenditures at the segment level.

We continue to expect our 2016 capital investment, which includes our capital expenditures plus vendor financing payments related to our Mexico network, for our existing businesses to be in the \$22,000 range, and we expect our capital investment to be in the 15 percent range of service revenues or lower for each of the years 2016 through 2018. The amount of capital investment is influenced by demand for services and products, capacity needs and network enhancements. We are also focused on ensuring merger commitments are met.

Cash Provided by or Used in Financing Activities

For the first six months of 2016, cash used in financing activities totaled \$6,103 and included net proceeds of \$10,140 primarily from the following long-term debt issuances:

- February issuance of \$1,250 of 2.800% global notes due 2021.
- February issuance of \$1,500 of 3.600% global notes due 2023.
- February issuance of \$1,750 of 4.125% global notes due 2026.
- February issuance of \$1,500 of 5.650% global notes due 2047.
- May issuance of \$750 of 2.300% global notes due 2019.
- May issuance of \$750 of 2.800% global notes due 2021.

- May issuance of \$1,100 of 3.600% global notes due 2023.
- May issuance of \$900 of 4.125% global notes due 2026.
- May issuance of \$500 of 4.800% global notes due 2044.

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During the first six months of 2016, we redeemed \$9,129 of debt, primarily consisting of the following:

- February redemption of \$1,250 of AT&T Floating Rate Notes due 2016.
- March prepayment of the remaining \$1,000 outstanding under a \$2,000 18-month credit agreement by and between AT&T and Mizuho.
- May redemption of \$1,750 of 2.950% global notes due 2016.
- June prepayment of \$5,000 of outstanding advances under our \$9,155 Syndicated Credit Agreement (See "Credit Facilities" below).

In July 2016, we made a refundable deposit with the FCC for the upcoming Auction 1000.

Our weighted average interest rate of our entire long-term debt portfolio, including the impact of derivatives, was approximately 4.2% as of June 30, 2016, compared to 4.1% as of March 31, 2016, and 4.0% as of December 31, 2015. We had \$125,568 of total notes and debentures outstanding at June 30, 2016, which included Euro, British pound sterling, Swiss Franc, Brazilian real and Canadian dollar denominated debt of approximately \$25,826.

As of June 30, 2016, we had approximately 402 million shares remaining from 2013 and 2014 authorizations from our Board of Directors to repurchase shares of our common stock. During the first six months of 2016, we repurchased approximately 5 million shares for \$197. In 2016, we intend to use free cash flow (operating cash flows less construction and capital expenditures) after dividends primarily to pay down debt.

We paid dividends of \$5,899 during the first six months of 2016, compared with \$4,873 for the first six months of 2015, primarily reflecting the increase in shares outstanding resulting from our acquisition of DIRECTV. Dividends declared by our Board of Directors totaled \$0.48 per share in the second quarter and \$0.96 per share for the first six months of 2016 and \$0.47 per share in the second quarter and \$0.94 per share for the first six months of 2015. Our dividend policy considers the expectations and requirements of stockholders, capital funding 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.

At June 30, 2016, we had \$9,528 of debt maturing within one year, \$9,004 of which was related to long-term debt issuances. Debt maturing within one year includes the following notes that may be put back to us by the holders:

- \$1,000 of annual put reset securities issued by BellSouth that may be put back to us each April until maturity in 2021.
- An accreting zero-coupon note that may be redeemed each May until maturity in 2022. If the zero-coupon note (issued for principal of \$500 in 2007) is held to maturity, the redemption amount will be \$1,030.

Credit Facilities

On December 11, 2015, we entered into a five-year, \$12,000 credit agreement (the "Revolving Credit Agreement") with Citibank, N.A. (Citibank), as administrative agent, replacing our \$5,000 credit agreement that would have expired in December 2018. At the same time, AT&T and the lenders terminated their obligations under the existing revolving \$3,000 credit agreement with Citibank that would have expired in December 2017.

In January 2015, we entered into a \$9,155 credit agreement (the "Syndicated Credit Agreement") containing (i) a \$6,286 term loan facility (the "Tranche A Facility") and (ii) a \$2,869 term loan facility (the "Tranche B Facility"), with certain investment and commercial banks and Mizuho Bank, Ltd. ("Mizuho"), as administrative agent.

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Revolving Credit Agreement

In the event advances are made under the Revolving Credit Agreement, those advances would be used for general corporate purposes. Advances are not conditioned on the absence of a material adverse change. All advances must be repaid no later than the date on which lenders are no longer obligated to make any advances under the agreement. We can terminate, in whole or in part, amounts committed by the lenders in excess of any outstanding advances; however, we cannot reinstate any such terminated commitments. We also may request that the total amount of the lender's commitments be increased by an integral multiple of \$25 effective on a date that is at least 90 days prior to the scheduled termination date then in effect, provided that no event of default has occurred and in no event shall the total amount of the lender's commitments at any time exceed \$14,000. At June 30, 2016, we had no advances outstanding under the Revolving Credit Agreement and we have complied with all covenants.

The obligations of the lenders to provide advances will terminate on December 11, 2020, unless prior to that date either: (i) AT&T reduces to \$0 the commitments of the lenders, or (ii) certain events of default occur. We and lenders representing more than 50% of the facility amount may agree to extend their commitments for two one-year periods beyond the December 11, 2020 termination date, under certain circumstances.

Advances under the Revolving Credit Agreement would bear interest, at AT&T's option, either:

at a variable annual rate equal to (i) the highest of: (a) the base rate of the bank affiliate of Citibank, N.A. which is serving as administrative agent under the Agreement, (b) 0.50% per annum above the Federal Funds Rate, and (c) the London Interbank Offered Rate (LIBOR) applicable to U.S. dollars for a period of one month plus 1.00% per annum, plus (ii) an applicable margin, as set forth in the Revolving Credit Agreement ("Applicable Margin for Base Advances"); or

at a rate equal to: (i) LIBOR for a period of one, two, three or six months, as applicable, plus (ii) the Applicable Margin ("Applicable Margin for Eurocurrency Rate Advances").

The Applicable Margin for Eurocurrency Rate Advances will equal 0.680%, 0.910%, 1.025% or 1.125% per annum, depending on AT&T's credit rating. The Applicable Margin for Base Rate Advances will be equal to the greater of 0.00% and the relevant Applicable Margin for Eurocurrency Rate Advances minus 1.00% per annum depending on AT&T's credit rating.

We will pay a facility fee of 0.070%, 0.090%, 0.100% or 0.125% per annum, depending on AT&T's credit rating, of the amount of lender commitments.

The Revolving Credit Agreement contains covenants that are customary for an issuer with an investment grade senior debt credit rating, as well as a net debt-to-EBITDA (earnings before interest, taxes, depreciation and amortization, and other modifications described in the Revolving Credit Agreement) financial ratio covenant that AT&T will maintain, as of the last day of each fiscal quarter of not more than 3.5-to-1.

The events of default contained in the Revolving Credit Agreement are customary for an agreement of this type and such events would result in the acceleration or permit the lenders to accelerate, as applicable, required payments and would increase the Applicable Margin by 2.00% per annum.

The Syndicated Credit Agreement

In March 2015, AT&T borrowed all amounts available under the Tranche A Facility and the Tranche B Facility. Amounts borrowed under the Tranche A Facility will be due on March 2, 2018. Amounts borrowed under the Tranche

B Facility will be subject to amortization from March 2, 2018, with 25 percent of the aggregate principal amount thereof being payable prior to March 2, 2020, and all remaining principal amount due on March 2, 2020. In June 2016, we repaid \$4,000 of the outstanding debt under the Tranche A Facility and \$1,000 of the outstanding debt under the Tranche B Facility. After repayment, the amortization in the Tranche B Facility has been satisfied.

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Advances bear interest at a rate equal to: (i) the LIBOR for deposits in dollars (adjusted upwards to reflect any bank reserve costs) for a period of three or six months, as applicable, plus (ii) the Applicable Margin (each such Advance, a Eurodollar Rate Advance). The Applicable Margin under the Tranche A Facility will equal 1.000%, 1.125% or 1.250% per annum depending on AT&T's credit rating. The Applicable Margin under the Tranche B Facility will equal 1.125%, 1.250% or 1.375% per annum, depending on AT&T's credit rating.

The Syndicated Credit Agreement contains covenants that are customary for an issuer with an investment grade senior debt credit rating, as well as a net debt-to-EBITDA (earnings before interest, taxes, depreciation and amortization, and other modifications described in the Syndicated Credit Agreement) financial ratio covenant that AT&T will maintain, as of the last day of each fiscal quarter of not more than 3.5-to-1.

The events of default contained in the Syndicated Credit Agreement are customary for an agreement of this type and such events would result in the acceleration or permit the lenders to accelerate, as applicable, required payments and would increase the Applicable Margin by 2.00% per annum.

Collateral Arrangements

During the first six months of 2016, we posted \$928 of additional cash collateral, on a net basis, to banks and other participants in our derivative arrangements, due mainly to the U.S. dollar strengthening versus the British pound sterling. Cash postings under these arrangements vary with changes in credit ratings and netting agreements. (See Note 6)

Other

Our total capital consists of debt (long-term debt and debt maturing within one year) and stockholders' equity. Our capital structure does not include debt issued by our equity method investments. At June 30, 2016, our debt ratio was 50.5%, compared to 55.5% at June 30, 2015, and 50.5% at December 31, 2015. Our net debt ratio was 47.6% at June 30, 2016, compared to 45.2% at June 30, 2015, and 48.5% at December 31, 2015. The debt ratio is affected by the same factors that affect total capital, and reflects our recent debt issuances and repayments.

During the first six months of 2016, we received \$2,773 from the monetization of various assets, primarily the sale of certain equipment installment receivables. We plan to continue to explore similar opportunities.

In 2013, we made a voluntary contribution of a preferred equity interest in AT&T Mobility II LLC (Mobility), the holding company for our U.S. wireless operations, to the trust used to pay pension benefits under our qualified pension plans. The preferred equity interest had a value of \$8,704 as of June 30, 2016, and \$8,714 as of December 31, 2015, does not have any voting rights and has a liquidation value of \$8,000. The trust is entitled to receive cumulative cash distributions of \$560 per annum, which are distributed quarterly in equal amounts. We distributed \$280 to the trust during the first six months of 2016. So long as we make the distributions, the terms of the preferred equity interest will not impose any limitations on our ability to declare a dividend or repurchase shares. At the time of the contribution of the preferred equity interest, we agreed to annual cash contributions to the trust of \$175 no later than the due date for our federal income tax return for each of 2015 and 2016.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Dollars in millions except per share amounts

At June 30, 2016, we had interest rate swaps with a notional value of \$7,050 and a fair value of \$202.

We have fixed-to-fixed and floating-to-fixed cross-currency swaps on foreign currency-denominated debt instruments with a U.S. dollar notional value of \$29,642 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 \$(3,721) at June 30, 2016.

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, 2016. 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, 2016.

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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 at favorable rates and terms.

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 United States and foreign securities markets, resulting in worse-than-assumed investment returns and discount rates; adverse changes in mortality assumptions; adverse medical cost trends, and unfavorable or delayed implementation of healthcare legislation, regulations or related court decisions.

The final outcome of FCC and other federal, state or foreign government agency proceedings (including judicial review, if any, of such proceedings) involving issues that are important to our business, including, without limitation, intercarrier compensation; interconnection obligations; pending Notices of Apparent Liability; the transition from legacy technologies to IP-based infrastructure including the withdrawal of legacy TDM-based services; universal service; broadband deployment; E911 services; competition policy; net neutrality; including the FCC's order reclassifying broadband as Title II services subject to much more fulsome regulation; unbundled network elements and other wholesale obligations; multi-channel video programming distributor services and equipment; availability of new spectrum, on fair and balanced terms, and wireless and satellite license awards and renewals.

The final outcome of state and federal legislative efforts involving issues that are important to our business, including deregulation of IP-based services, relief from Carrier of Last Resort obligations and elimination of state commission review of the withdrawal of services.

Enactment of additional state, local, federal and/or foreign regulatory and tax laws and regulations, or changes to existing standards and actions by tax agencies and judicial authorities including the resolution of disputes with any taxing jurisdictions, 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 or delivery methods (e.g., cable, wireless, VoIP and Over The Top Video service) and our ability to maintain capital expenditures.

The extent of competition including from governmental networks and other providers and the resulting pressure on customer and access line totals and segment operating margins.

Our ability to develop attractive and profitable product/service offerings to offset increasing competition.

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 continued development and delivery of attractive and profitable video offerings through satellite and U-verse; the extent to which regulatory and build-out requirements apply to our offerings; and the availability, cost and/or reliability of the various technologies and/or content required to provide such offerings.

Our continued ability to maintain margins, attract and offer a diverse portfolio of wireless service and devices and device financing plans.

The availability and cost of additional wireless spectrum and regulations and conditions relating to spectrum use, licensing, obtaining additional spectrum, technical standards and deployment and usage, including network management rules.

Our ability to manage growth in wireless data services, including network quality and acquisition of adequate spectrum at reasonable costs and terms.

The outcome of pending, threatened or potential litigation, including, without limitation, patent and product safety claims by or against third parties.

The impact from major equipment failures on our networks, including satellites operated by DIRECTV; the effect of security breaches related to the network or customer information; our inability to obtain handsets, equipment/software or have handsets, equipment/software serviced in a timely and cost-effective manner from suppliers; and in the case of satellites launched, timely provisioning of services from vendors; or 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.

Our ability to integrate our acquisition of DIRECTV.

Our ability to adequately fund our wireless operations, including payment for additional spectrum, network upgrades and technological advancements.

Our increased exposure to video competition and foreign economies due to our recent acquisitions of DIRECTV and Mexican wireless properties, including foreign exchange fluctuations as well as regulatory and political uncertainty in Latin America.

Changes in our corporate strategies, such as changing network requirements or acquisitions and dispositions, which may require significant amounts of cash or stock, to respond to competition and regulatory, legislative and technological developments.

The uncertainty surrounding further congressional action to address spending reductions, which may result in a significant decrease in government spending and reluctance of businesses and consumers to spend in general.

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

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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 2016, there were no such material developments.

Item 2. Unregistered Sales of Equity Securities
and Use of Proceeds

(c) A summary of our repurchases of common stock during the second quarter of 2016 is as follows:

| (a) Period | (b) Total Number of Shares (or Units) Purchased 1, 2, 3 | (c) Average Price Paid Per Share (or Unit) | (d) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs ¹ | Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under The Plans or Programs |
|-----------------------------------|---|---|--|--|
| | | | | (d) |
| April 1, 2016 - April 30, 2016 | 14,308 | \$- | - | 406,550,000 |
| May 1, 2016 - May 31, 2016 | 3,001,139 | 38.43 | 3,000,000 | 403,550,000 |
| June 1, 2016 - June 30, 2016 | 2,658,815 | 40.87 | 2,000,000 | 401,550,000 |
| Total | 5,674,262 | \$39.40 | 5,000,000 | |

¹ In March 2014, our Board of Directors approved an additional authorization to repurchase up to 300 million shares of our common stock. In March 2013, our Board of Directors authorized the repurchase of up to an additional 300 million shares of our common stock. The authorizations have no expiration date.

² Of the shares repurchased, 32,522 shares were acquired through the withholding of taxes on the vesting of restricted stock or through the payment in stock of taxes on the exercise price of options.

³ Of the shares repurchased, 641,740 shares were acquired through reimbursements from AT&T maintained Voluntary Employee Benefit Association (VEBA) trusts.

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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.

- 12 Computation of Ratios of Earnings to Fixed Charges
 - Rule 13a-14(a)/15d-14(a) Certifications
- 31 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.

/s/ John J. Stephens

August 4, 2016

John J. Stephens
Senior Executive Vice President
and Chief Financial Officer