

AT&T INC.
Form 10-Q
August 03, 2007

FORM 10-Q

**United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

(Mark One)

- Quarterly Report Pursuant to Section 13 or
15(d) of the
Securities Exchange Act of 1934

For the quarterly period ended June 30, 2007

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

175 E. Houston, San Antonio, Texas 78205
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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer [X] Accelerated filer [] Non-accelerated filer []

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

At July 25, 2007, common shares outstanding were 6,098,970,990.

PART I - FINANCIAL INFORMATION**Item 1. Financial Statements****AT&T INC.****CONSOLIDATED STATEMENTS OF INCOME**

Dollars in millions except per share amounts

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Operating Revenues				
Voice	\$ 10,378	\$ 8,509	\$ 20,833	\$ 17,124
Data	5,746	4,534	11,401	9,035
Wireless service	9,513	8	18,583	16
Directory	1,155	909	2,177	1,810
Other	2,686	1,810	5,453	3,541
Total operating revenues	29,478	15,770	58,447	31,526
Operating Expenses				
Cost of sales (exclusive of depreciation and amortization shown separately below)	11,478	7,163	22,730	14,527
Selling, general and administrative	7,640	3,517	15,077	7,226
Depreciation and amortization	5,416	2,486	11,032	4,978
Total operating expenses	24,534	13,166	48,839	26,731
Operating Income	4,944	2,604	9,608	4,795
Other Income (Expense)				
Interest expense	(879)	(472)	(1,752)	(936)
Interest income	39	95	74	180
Equity in net income of affiliates	210	455	383	789
Other income (expense) – net	88	15	557	26
Total other income (expense)	(542)	93	(738)	59
Income Before Income Taxes	4,402	2,697	8,870	4,854
Income taxes	1,498	889	3,118	1,601
Net Income	\$ 2,904	\$ 1,808	\$ 5,752	\$ 3,253
Earnings Per Common Share:				
Net Income	\$ 0.47	\$ 0.47	\$ 0.93	\$ 0.84
Earnings Per Common Share - Assuming Dilution:				
Net Income	\$ 0.47	\$ 0.46	\$ 0.92	\$ 0.83
Weighted Average Number of Common				
Shares Outstanding – Basic (in millions)	6,145	3,886	6,184	3,884
Dividends Declared Per Common Share	\$ 0.3550	\$ 0.3325	\$ 0.7100	\$ 0.6650

See Notes to Consolidated Financial Statements.

AT&T INC.**CONSOLIDATED BALANCE SHEETS**

Dollars in millions except per share amounts

	June 30, 2007	December 31, 2006
Assets	(Unaudited)	
Current Assets		
Cash and cash equivalents	\$ 2,570	\$ 2,418
Accounts receivable – net of allowances for uncollectibles of \$1,371 and \$1,276	15,368	16,194
Prepaid expenses	1,743	1,477
Deferred income taxes	2,360	3,034
Other current assets	2,352	2,430
Total current assets	24,393	25,553
Property, plant and equipment	203,845	202,149
Less: accumulated depreciation and amortization	109,790	107,553
Property, Plant and Equipment – Net	94,055	94,596
Goodwill	67,072	67,657
Licenses	35,370	34,252
Customer Lists and Relationships – Net	16,683	18,922
Other Intangible Assets – Net	6,064	6,566
Investments in Equity Affiliates	2,342	1,995
Postemployment Benefit	14,519	14,228
Other Assets	6,848	6,865
Total Assets	\$ 267,346	\$ 270,634
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	\$ 7,701	\$ 9,733
Accounts payable and accrued liabilities	19,171	22,106
Advanced billing and customer deposits	3,567	3,402
Accrued taxes	5,932	3,026
Dividends payable	2,168	2,215
Total current liabilities	38,539	40,482
Long-Term Debt	53,970	50,063
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	20,475	27,406
Postemployment benefit obligation	28,609	28,901
Unamortized investment tax credits	166	181
Other noncurrent liabilities	13,926	8,061
Total deferred credits and other noncurrent liabilities	63,176	64,549
Stockholders' Equity		
Common shares issued (\$1 par value)	6,495	6,495
Capital in excess of par value	91,277	91,352
Retained earnings	31,706	30,375
Treasury shares (at cost)	(12,751)	(7,368)
Accumulated other comprehensive income	(5,066)	(5,314)
Total stockholders' equity	111,661	115,540

Total Liabilities and Stockholders' Equity	\$ 267,346	\$ 270,634
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See Notes to Consolidated Financial Statements.

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AT&T INC.**CONSOLIDATED STATEMENTS OF CASH FLOWS**

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

	Six months ended June 30,	
	2007	2006
Operating Activities		
Net income	\$ 5,752	\$ 3,253
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,032	4,978
Undistributed earnings from investments in equity affiliates	(344)	(752)
Provision for uncollectible accounts	738	320
Amortization of investment tax credits	(15)	(14)
Deferred income tax (benefit) expense	(546)	65
Net gain on sales of investments	(64)	(10)
Gain on license exchange	(409)	-
Changes in operating assets and liabilities:		
Accounts receivable	87	545
Other current assets	(665)	(84)
Accounts payable and accrued liabilities	(287)	(1,376)
Stock-based compensation tax benefit	(107)	(5)
Other - net	(171)	233
Total adjustments	9,249	3,900
Net Cash Provided by Operating Activities	15,001	7,153
Investing Activities		
Construction and capital expenditures	(7,460)	(4,042)
Net investments in affiliates	-	(717)
Dispositions	520	55
Acquisitions, net of cash acquired	(221)	(115)
Proceeds from sale of marketable securities	471	-
Proceeds from sale of debt and equity securities	227	-
Investments in debt and equity securities	(189)	-
Other	17	7
Net Cash Used in Investing Activities	(6,635)	(4,812)
Financing Activities		
Net change in short-term borrowings with original maturities of three months or less	(1,993)	1,020
Issuance of long-term debt	5,924	1,491
Repayment of long-term debt	(2,065)	(2,540)
Purchase of treasury shares	(6,904)	(148)
Issuance of treasury shares	1,252	236
Dividends paid	(4,414)	(2,581)
Stock-based compensation tax benefit	107	5
Other	(121)	49
Net Cash Used in Financing Activities	(8,214)	(2,468)
Net increase (decrease) in cash and cash equivalents	152	(127)
Cash and cash equivalents beginning of year	2,418	1,224
Cash and Cash Equivalents End of Period	\$ 2,570	\$ 1,097

Cash paid during the six months ended June 30 for:

Interest	\$	1,571	\$	1,015
Income taxes, net of refunds	\$	1,484	\$	979

See Notes to Consolidated Financial Statements.

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AT&T INC.**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**

Dollars and shares in millions, except per share amounts
(Unaudited)

	Six months ended June 30, 2007	
	Shares	Amount
Common Stock		
Balance at beginning of year	6,495	\$ 6,495
Balance at end of period	6,495	\$ 6,495
Capital in Excess of Par Value		
Balance at beginning of year		\$ 91,352
Issuance of shares		(80)
Stock based compensation		5
Balance at end of period		\$ 91,277
Retained Earnings		
Balance at beginning of year		\$ 30,375
Net income (\$0.92 per diluted share)		5,752
Dividends to stockholders (\$0.71 per share)		(4,368)
Adoption of FIN 48		(50)
Other		(3)
Balance at end of period		\$ 31,706
Treasury Shares		
Balance at beginning of year	(256)	\$ (7,368)
Purchase of shares	(179)	(6,904)
Issuance of shares	47	1,521
Balance at end of period	(388)	\$ (12,751)
Accumulated Other Comprehensive Income, net of tax		
Balance at beginning of year		\$ (5,314)
Purchase accounting adjustment to apply FAS 158, net of tax		46
Other comprehensive income (loss) (see Note 3)		202
Balance at end of period		\$ (5,066)

See Notes to Consolidated Financial Statements.

AT&T INC.
JUNE 30, 2007

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Dollars in millions except per share amounts

NOTE 1. PREPARATION OF INTERIM FINANCIAL STATEMENTS

Basis of Presentation Throughout this document, AT&T Inc. is referred to as “AT&T,” “we” or the “Company.” The consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) that permit reduced disclosure for interim periods. We believe that these consolidated financial statements include all adjustments (consisting only of normal recurring accruals) necessary to present fairly the results for the interim periods shown. The results for the interim periods are not necessarily indicative of results 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, 2006 and our Form 10-Q(s) for interim periods.

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

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Prior to the closing of the BellSouth Corporation (BellSouth) acquisition on December 29, 2006, we accounted for our joint ventures with BellSouth under the equity method since we shared control equally. Thus, for 2006 we recorded as equity income our proportionate share of economic ownership in these joint ventures, namely, 60% of AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC and 66% of YELLOWPAGES.COM (YPC). AT&T Mobility and YPC became wholly-owned subsidiaries of AT&T on December 29, 2006. Earnings from certain foreign equity investments accounted for using the equity method are included for periods ended within up to one month of our period end.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (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. We have reclassified certain amounts in prior-period financial statements to conform to the current period’s presentation.

Employee Separations In accordance with Statement of Financial Accounting Standards No. 112, “Employers’ Accounting for Postemployment Benefits,” we establish obligations for expected termination benefits provided under existing plans to former or inactive employees after employment but before retirement. These benefits include severance payments, workers’ compensation, disability, medical continuation coverage and other benefits. At June 30, 2007, we had severance accruals of \$225, of which \$209 were established as merger-related severance accruals. At December 31, 2006, we had severance accruals of \$263.

New Accounting Standards

FIN 48 We adopted FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (FIN 48) on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes.” The Interpretation prescribes a threshold for the financial statement recognition and measurement of a tax position taken or

expected to be taken within an income tax return. For each tax position, the enterprise must determine whether it is more likely than not that the position will be sustained upon examination based on the technical merits of the position, including resolution of any related appeals or litigation. A tax position that meets the more likely than not recognition threshold is then measured to determine the amount of benefit to recognize within the financial statements. No benefits may be recognized for tax positions that do not meet the more likely than not threshold. As required by FIN 48, we reclassified deferred income tax liabilities of \$6,225 from our "Deferred income taxes" for unrecognized tax benefits, of which \$6,100 was included in "Other noncurrent liabilities" and \$175 was included in "Accrued taxes" on our Consolidated Balance Sheets and the remaining \$50 was recorded as a reduction to the beginning of year retained earnings to reflect the cumulative effect of adoption of FIN 48. In May 2007, the FASB issued further guidance on whether a tax position is effectively settled, the adoption of which did not have a material impact.

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

Dollars in millions except per share amounts

The total amount of unrecognized tax benefits including interest and penalties at January 1, 2007 was \$6,275. Of this total, \$1,913 represents the amount of unrecognized tax benefits that, if recognized, would favorably affect income tax expense in future periods. The \$1,913 reflects the liabilities for unrecognized tax benefits net of related deferred tax assets. During the second quarter, we reduced our unrecognized tax benefits by \$84 related primarily to payments and the favorable resolution of a contested interest assessment partially offset by interest accruals and current period unrecognized tax benefits. The total amount of unrecognized tax benefits including interest and penalties at June 30, 2007 was \$6,181, of which \$5,651 was included in "Other noncurrent liabilities" and \$530 was included in "Accrued taxes" on our Consolidated Balance Sheets. Of the June 30, 2007 balance, \$1,861 represents the amount of unrecognized tax benefits that, if recognized, would favorably affect income tax expense in future periods. This amount is net of related deferred tax assets.

We record interest and penalties related to federal, state and foreign unrecognized tax benefits in income tax expense. Accrued interest and penalties included in unrecognized tax benefits were \$1,380 and \$1,450 as of January 1, 2007 and June 30, 2007, respectively.

It is reasonably possible that the total amount of unrecognized tax benefits may be reduced within the next 12 months as a result of ongoing discussions we are having with the Internal Revenue Service (IRS) under their "Expedited Resolution of Uncertain Tax Positions Initiative." In these discussions we expect to settle an issue related to capital losses claimed on our 2002 tax return, which may impact our income tax expense. We are not able to determine the amount at this time.

The Company and our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. Our income tax returns are regularly audited and reviewed by the IRS as well as state and foreign taxing authorities.

The IRS has completed field examinations of AT&T's tax returns and all audit periods prior to 1997 are closed for federal purposes. We were unable to reach agreement with the IRS on one issue in the 1997-1999 audit and as a result, during the first quarter of 2007, we filed a refund suit in U.S. District Court. We do not expect to resolve this dispute in the next twelve months. During 2006, the IRS completed its field examination of the 2000-2002 tax returns for AT&T. As some issues were not resolved, the case has been forwarded to the IRS Appeals Division (Appeals), and settlement meetings with Appeals will begin during 2007. We do not expect resolution of this cycle during 2007. Additionally, during 2006, the IRS began its field examination of the AT&T 2003-2005 tax returns and we do not expect the IRS to complete this examination during 2007. We do not expect resolution of these audit cycles to have a material adverse impact.

The IRS has completed the examination of all acquired entity tax returns through 2003 (AT&T Corp. (ATTC) through 2004) and, with the exception of BellSouth, all years through 2001 are closed. Appeals has issued BellSouth an assessment for years 1999-2001, which was paid during the second quarter and we are reviewing our options with this case. We expect to continue to progress through the normal audit and appeals process for all entities during 2007, but we do not expect the resolution of these items to have a material adverse impact.

FAS 159 In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (FAS 159). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value, providing the opportunity to mitigate volatility in

reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. FAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact FAS 159 will have on our financial position and results of operations.

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

Dollars in millions except per share amounts

EITF 06-11 In June 2007, the EITF ratified the consensus on EITF 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards". EITF 06-11 provides that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for nonvested equity-classified share-based awards and equity-classified outstanding share options should be recognized as an increase to additional paid-in capital rather than a reduction of income tax expense. EITF 06-11 applies prospectively to the income tax benefits that result from dividends on equity-classified employee share-based payment awards that are declared in fiscal periods beginning after December 15, 2007. We are currently evaluating the impact EITF 06-11 will have on our financial position and results of operations.

NOTE 2. ACQUISITIONS, DISPOSITIONS, VALUATION AND OTHER ADJUSTMENTS

Acquisitions

BellSouth Corporation In December 2006, we acquired BellSouth in a transaction accounted for under Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), issuing 2.4 billion shares. BellSouth was the leading communications service provider in the southeastern U.S., providing wireline communications services, including local exchange, network access, long-distance services and Internet services to substantial portions of the population across nine states. BellSouth also provided long-distance services to enterprise customers throughout the country.

We and BellSouth jointly owned AT&T Mobility and the Internet-based publisher YPC. In the AT&T Mobility joint venture, we held a 60% economic interest and BellSouth held a 40% economic interest and in the YPC joint venture, we held a 66% economic interest and BellSouth held a 34% economic interest. For each joint venture, control was shared equally. We and BellSouth each accounted for the joint ventures under the equity method of accounting, recording the proportional share of AT&T Mobility's and YPC's income as equity in net income of affiliates on the respective consolidated statements of income and reporting the ownership percentage of AT&T Mobility's net assets as "Investments in and Advances to AT&T Mobility" and the ownership percentage of YPC's net assets as "Investments in Equity Affiliates" on the respective consolidated balance sheets. After the BellSouth acquisition, BellSouth, AT&T Mobility and YPC became wholly-owned subsidiaries of AT&T, and the operational results of these companies have been included in our consolidated financial statements since the December 29, 2006 acquisition date.

Under the purchase method of accounting, the transaction was valued, for accounting purposes, at approximately \$66,800. The assets and liabilities of BellSouth and AT&T Mobility have been preliminarily appraised, based on third-party valuations, for inclusion in the balance sheet, adjusting 100% of BellSouth's and 40% of AT&T Mobility's values. Long-lived assets such as property, plant and equipment reflect a value of replacing the assets, which takes into account changes in technology, usage, and relative obsolescence and depreciation of the assets, sometimes referred to as a "Greenfield approach." This approach often results in differences, sometimes material, from recorded book values even if, absent the acquisition, the assets would not be impaired. In addition, assets and liabilities that would not normally be recorded in ordinary operations (i.e. customer relationships) will be recorded at their acquisition values. Debt instruments and investments are valued in relation to current market conditions and other assets and liabilities are valued based on the acquiring company's estimates. After all values have been assigned to assets and liabilities, the remainder of the purchase price is recorded as goodwill. These values are subject to adjustment for one year after the close of the transaction as additional information is obtained, and those adjustments could be material.

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

Dollars in millions except per share amounts

The following table summarizes the preliminary estimated fair values of the BellSouth assets acquired and liabilities assumed and related deferred income taxes as of the acquisition date and adjustments made thereto during the first six months of 2007.

	BellSouth Purchase Price Allocation		
	As of 12/31/06	Adjustments	As of 6/30/07
Assets acquired			
Current assets	\$ 4,875	\$ (252)	\$ 4,623
Property, plant and equipment	18,498	397	18,895
Intangible assets not subject to amortization:			
Trademark/name	330	-	330
Licenses	214	100	314
Intangible assets subject to amortization:			
Customer lists and relationships	9,230	145	9,375
Patents	100	-	100
Trademark/name	211	-	211
Investments in AT&T Mobility	32,759	-	32,759
Other investments	2,446	(3)	2,443
Other assets	11,211	(97)	11,114
Goodwill	26,467	(178)	26,289
Total assets acquired	106,341	112	106,453
Liabilities assumed			
Current liabilities, excluding current portion of long-term debt	5,288	53	5,341
Long-term debt	15,628	(4)	15,624
Deferred income taxes	10,318	(22)	10,296
Postemployment benefit obligation	7,086	(70)	7,016
Other noncurrent liabilities	1,223	134	1,357
Total liabilities assumed	39,543	91	39,634
Net assets acquired	\$ 66,798	\$ 21	\$ 66,819

Adjustments were primarily related to finalization of participant count estimates used in the opening balance sheet valuation for the pension and postretirement plans, a gain on a contingency related to an insurance claim recovery for Hurricane Katrina damages, tax impacts related to AT&T Mobility's purchase accounting adjustments, the valuation of certain licenses and a decrease in the estimate of relative obsolescence of property, plant and equipment resulting in an increase in value and longer average remaining economic life. Deferred tax adjustments are associated with the above-mentioned items.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

BellSouth's 40% economic ownership of AT&T Mobility has been recorded above as "Investment in AT&T Mobility," and has been eliminated in our Consolidated Balance Sheets. We have recorded the consolidation of AT&T Mobility as a step acquisition, retaining 60% of AT&T Mobility's prior book value and adjusting the remaining 40% to fair value. The following table summarizes the preliminary estimated fair values (40%) and historical book values (60%) of the AT&T Mobility assets acquired and liabilities assumed and related deferred income taxes as of the acquisition date and adjustments made thereto during the first six months of 2007.

	Fair Value Adjustments AT&T Mobility		
	As of 12/31/06	Adjustments	As of 6/30/07
Assets acquired			
Current assets	\$ 6,988	\$ 3	\$ 6,991
Property, plant and equipment	19,687	(392)	19,295
Intangible assets not subject to amortization:			
Licenses	33,979	561	34,540
Intangible assets subject to amortization:			
Customer lists and relationships	7,583	479	8,062
Trademark/names	343	(127)	216
Other	176	(44)	132
Other assets	1,086	2	1,088
Goodwill	27,429	(206)	27,223
Total assets acquired	97,271	276	97,547
Liabilities assumed			
Current liabilities, excluding current portion of long-term debt	7,014	278	7,292
Intercompany debt	9,043	-	9,043
Long-term debt	12,559	-	12,559
Deferred income taxes	5,459	37	5,496
Postemployment benefit obligation	301	93	394
Other noncurrent liabilities	2,007	(88)	1,919
Total liabilities assumed	36,383	320	36,703
Net assets acquired	\$ 60,888	\$ (44)	\$ 60,844

Adjustments were primarily related to valuation estimates that, due to the proximity of the merger to year-end, were based on data from periods prior to the close of the December 29, 2006 acquisition. Using the December 29, 2006 data, purchase price allocations decreased the opening balance sheet values of property, plant and equipment, trademark/names and other intangibles, offset by an increased value of licenses and customer lists and relationships acquired. Deferred tax adjustments are associated with the above-mentioned items.

We continue to evaluate the overall integration and operation of our networks resulting from the acquisition. This may result in additional revisions during the purchase price allocation period and adjustments could be material.

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

Dollars in millions except per share amounts

Valuation and Other Adjustments

As ATTC and BellSouth stock options that were converted at the time of the respective mergers are exercised, the tax effect on those options may further reduce goodwill. As of June 30, 2007, we had recorded \$6 in related goodwill reductions for ATTC and \$23 for BellSouth.

Included in the current liabilities reported on our Consolidated Balance Sheet are accruals established under EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination" (EITF 95-3). The liabilities include accruals for severance, lease terminations and equipment removal costs associated with our acquisitions of ATTC and BellSouth.

Included in the liabilities assumed for the December 2006 acquisition of BellSouth was accrued severance of \$535 for BellSouth employees and \$44 for AT&T Mobility employees, all of which will be paid from company cash. In addition to the severance accruals, we also maintained the accruals that were established by AT&T Mobility associated with their acquisition of AT&T Wireless, Inc. (AWE). The AWE-related accruals are for plans affecting the integration of retail stores, administrative space and networks acquired in AT&T Mobility's acquisition of AWE. During the second quarter of 2007, we recorded additional accruals for lease terminations and equipment removal costs at AT&T Mobility. We will continue to evaluate these accruals through the end of the allocation period.

Following is a summary of the accruals recorded at December 31, 2006, cash payments made during the first six months of 2007 and the purchase accounting adjustments thereto, for the acquisitions of ATTC and BellSouth.

	12/31/06 Balance	Cash Payments	Additional Accruals	Adj.	6/30/07 Balance
Severance accruals paid from:					
Company funds	\$ 986	\$ (267)	\$ 18	\$ (57)	\$ 680
Pension and postemployment benefit plans	183	(26)	-	-	157
Lease terminations	146	(42)	156	(2)	258
Equipment removal and other related costs	117	(96)	97	(2)	116
Total	\$ 1,432	\$ (431)	\$ 271	\$ (61)	\$ 1,211

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

Dollars in millions except per share amounts

NOTE 3. COMPREHENSIVE INCOME

The components of our comprehensive income for the three and six months ended June 30, 2007 and 2006 include net income, adjustments to stockholders' equity for the foreign currency translation adjustment, net unrealized gain (loss) on available-for-sale securities and net unrealized gain (loss) on cash flow hedges and defined benefit postretirement plans. The foreign currency translation adjustment was due to exchange rate fluctuations in our foreign affiliates' local currencies, and the reclassification adjustment on cash flow hedges was due to the amortization of losses from our interest rate forward contracts.

Following is our comprehensive income:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Net income	\$ 2,904	\$ 1,808	\$ 5,752	\$ 3,253
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	44	(25)	18	(45)
Net unrealized gains (losses) on securities:				
Unrealized gains (losses)	68	7	149	34
Reclassification adjustment for gains realized in net income	(40)	(2)	(40)	(8)
Net unrealized gains on cash flow hedges:				
Unrealized gains (losses)	(13)	2	(36)	2
Reclassification adjustment for losses realized in net income	4	4	8	8
Defined benefit postretirement plans:				
Amortization of net actuarial loss included in net income	91	-	175	-
Amortization of prior service benefit included in net income	(35)	-	(71)	-
Other	1	-	(1)	1
Other comprehensive income (loss)	120	(14)	202	(8)
Total Comprehensive Income	\$ 3,024	\$ 1,794	\$ 5,954	\$ 3,245

AT&T INC.
JUNE 30, 2007

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

NOTE 4. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for net income for the three and six months ended June 30, 2007 and 2006 are shown in the table below:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Numerators				
Numerator for basic earnings per share:				
Income from continuing operations	\$ 2,904	\$ 1,808	\$ 5,752	\$ 3,253
Dilutive potential common shares:				
Other stock-based compensation	2	1	4	3
Numerator for diluted earnings per share	\$ 2,906	\$ 1,809	\$ 5,756	\$ 3,256
Denominators (000,000)				
Denominator for basic earnings per share:				
Weighted-average number of common shares outstanding	6,145	3,886	6,184	3,884
Dilutive potential common shares:				
Stock options	26	2	24	2
Other stock-based compensation	24	17	22	17
Denominator for diluted earnings per share	6,195	3,905	6,230	3,903
Basic earnings per share				
Net income	\$ 0.47	\$ 0.47	\$ 0.93	\$ 0.84
Diluted earnings per share				
Net income	\$ 0.47	\$ 0.46	\$ 0.92	\$ 0.83

At June 30, 2007, we had issued and outstanding options to purchase approximately 261 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 95 million shares in the second quarter and 113 million for the first six months exceeded the average market price of AT&T stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective periods. At June 30, 2007, the exercise prices of 166 million share options were below market price.

At June 30, 2006, we had issued and outstanding options to purchase 247 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 217 million shares in the second quarter and 224 million for the first six months exceeded the average market price of AT&T stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective periods.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

NOTE 5. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. We analyze our various operating segments based on segment income before income taxes. Interest expense, interest income and other income (expense) – net are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in the calculation of each segment's percentage of our consolidated results. As a result of the December 29, 2006 acquisition of BellSouth we have revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segments. We have four reportable segments: (1) wireline, (2) wireless, (3) advertising & publishing and (4) other.

The wireline segment provides both retail and wholesale landline communications services, including local and long-distance voice, switched access, Internet protocol and Internet access data, messaging services, managed networking to business customers, AT&T U-versesm TV service (U-verse) and satellite television services through our agreements with EchoStar Communications Corp. and the DIRECTV Group, Inc.

The wireless segment provides voice, data and other wireless communications services, and includes 100% of the results of AT&T Mobility, which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. In 2006, although we analyzed AT&T Mobility's revenues and expenses under the wireless segment, we eliminated the wireless segment in our consolidated financial statements. In our 2006 consolidated financial statements we reported our 60% proportionate share of AT&T Mobility's results as equity in net income of affiliates.

The advertising & publishing segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. This segment also includes the results of YPC, which was a joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. For segment reporting disclosure, we have carried forward the deferred revenue and deferred cost balances for BellSouth at the acquisition date in order to reflect how the segment is managed. This is different for consolidated reporting purposes as under FAS 141, BellSouth deferred revenue and expenses from directories published during the twelve-month period ending with the December 29, 2006 acquisition date, are not recognized and therefore were not included in the opening balance sheet. For management reporting purposes, we continue to amortize these balances over the life of the directory. Thus, our advertising & publishing segment results include revenue of \$306 in the second quarter and \$715 for the first six months and expenses of \$119 in the second quarter and \$227 for the first six months of 2007, related to directories published in the Southeast region during 2006, prior to our acquisition of BellSouth. These amounts are eliminated in the consolidations and eliminations column in the reconciliation below.

The other segment includes results from Sterling Commerce Inc., customer information services and all corporate and other operations. This segment includes our portion of the results from our international equity investments. Prior to December 29, 2006, this segment also included our results from AT&T Mobility as equity in net income of affiliates, as discussed above.

In the following tables, we show how our segment results are reconciled to our consolidated results reported in accordance with GAAP. The Wireline, Wireless, Advertising & Publishing and Other columns represent the segment results of each such operating segment. The Consolidation and Elimination column adds in those line items that we manage on a consolidated basis only: interest expense, interest income and other income (expense) – net. This column

also eliminates any intercompany transactions included in each segment's results as well as the advertising and publishing revenue and expenses in 2007 related to directories published in the Southeast region during 2006, mentioned previously. In 2006, since our 60% share of the results from AT&T Mobility is already included in the Other column, the Wireless Elimination column removes the non-consolidated results shown in the wireless segment.

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JUNE 30, 2007

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

For the three months ended June 30, 2007

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	\$ 17,478	\$ 10,368	\$ 1,461	\$ 477	\$ (306)	\$ 29,478
Intersegment revenues	515	27	17	81	(640)	-
Total segment operating revenues	17,993	10,395	1,478	558	(946)	29,478
Operations and support expenses	11,582	6,981	792	520	(757)	19,118
Depreciation and amortization expenses	3,300	1,810	263	44	(1)	5,416
Total segment operating expenses	14,882	8,791	1,055	564	(758)	24,534
Segment operating income	3,111	1,604	423	(6)	(188)	4,944
Interest expense	-	-	-	-	879	879
Interest income	-	-	-	-	39	39
Equity in net income (loss) of affiliates ¹	-	(50)	-	202	58	210
Other income (expense) – net	-	-	-	-	88	88
Segment income before income taxes	\$ 3,111	\$ 1,554	\$ 423	\$ 196	\$ (882)	\$ 4,402

¹ The Wireless column includes minority interest recorded as Other Income (Expense) – Net on the Consolidated Statements of Income

At June 30, 2007 or for the six months ended

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	\$ 34,954	\$ 20,343	\$ 2,892	\$ 973	\$ (715)	\$ 58,447
Intersegment revenues	1,025	49	29	129	(1,232)	-
Total segment operating revenues	35,979	20,392	2,921	1,102	(1,947)	58,447
Operations and support expenses	23,233	13,564	1,526	941	(1,457)	37,807
Depreciation and amortization expenses	6,740	3,701	505	87	(1)	11,032
Total segment operating expenses	29,973	17,265	2,031	1,028	(1,458)	48,839

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Segment operating income	6,006	3,127	890	74	(489)	9,608
Interest expense	-	-	-	-	1,752	1,752
Interest income	-	-	-	-	74	74
Equity in net income (loss) of affiliates ¹	-	(91)	-	374	100	383
Other income (expense) – net	-	-	-	-	557	557
Segment income before income taxes	\$ 6,006	\$ 3,036	\$ 890	\$ 448	\$ (1,510)	\$ 8,870
Segment Assets	\$ 226,215	\$ 96,128	\$ 9,133	\$ 165,628	\$ (229,758)	\$ 267,346

¹ The Wireless column includes minority interest recorded as Other Income (Expense) – Net on the Consolidated Statements of Income

AT&T INC.
JUNE 30, 2007

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

For the three months ended June 30,
2006

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	\$ 14,435	\$ 9,225	\$ 909	\$ 418	\$ -	\$ (9,217)	\$ 15,770
Intersegment revenues	1	-	9	37	(47)	-	-
Total segment operating revenues	14,436	9,225	918	455	(47)	(9,217)	15,770
Operations and support expenses	9,984	6,603	428	314	(46)	(6,603)	10,680
Depreciation and amortization expenses	2,438	1,605	-	42	(2)	(1,597)	2,486
Total segment operating expenses	12,422	8,208	428	356	(48)	(8,200)	13,166
Segment operating income	2,014	1,017	490	99	1	(1,017)	2,604
Interest expense	-	-	-	-	472	-	472
Interest income	-	-	-	-	95	-	95
Equity in net income (loss) of affiliates ¹	-	(28)	(6)	446	-	43	455
Other income (expense) – net	-	-	-	-	15	-	15
Segment income before income taxes	\$ 2,014	\$ 989	\$ 484	\$ 545	\$ (361)	\$ (974)	\$ 2,697

¹ The Wireless column includes minority interest recorded as Other Income (Expense) – Net on the Consolidated Statements of Income

For the six months ended June 30,
2006

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	\$ 28,856	\$ 18,213	\$ 1,809	\$ 845	\$ -	\$ (18,197)	\$ 31,526
Intersegment revenues	1	-	24	76	(101)	-	-
	28,857	18,213	1,833	921	(101)	(18,197)	31,526

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Total segment operating revenues								
Operations and support expenses	20,325	13,096	867	661	(100)	(13,096)	21,753	
Depreciation and amortization expenses	4,879	3,292	1	85	(2)	(3,277)	4,978	
Total segment operating expenses	25,204	16,388	868	746	(102)	(16,373)	26,731	
Segment operating income	3,653	1,825	965	175	1	(1,824)	4,795	
Interest expense	-	-	-	-	936	-	936	
Interest income	-	-	-	-	180	-	180	
Equity in net income (loss) of affiliates ¹	-	(63)	(11)	777	1	85	789	
Other income (expense) – net	-	-	-	-	26	-	26	
Segment income before income taxes	\$ 3,653	\$ 1,762	\$ 954	\$ 952	\$ (728)	\$ (1,739)	\$ 4,854	

¹ The Wireless column includes minority interest recorded as Other Income (Expense) – Net on the Consolidated Statements of Income

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

Dollars in millions except per share amounts

NOTE 6. PENSION AND POSTRETIREMENT BENEFITS

Substantially all of our employees are covered by one of various noncontributory pension and death benefit plans. We also provide certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits. Our objective in funding these plans, in combination with the standards of the Employee Retirement Income Security Act of 1974, as amended (ERISA), is to accumulate assets sufficient to meet the plans' obligations to provide benefits to employees upon their retirement. No significant cash contributions are required under ERISA regulations during 2007.

The following details pension and postretirement benefit costs included in operating expenses (in cost of sales and selling, general and administrative expenses) in the accompanying Consolidated Statements of Income. We account for these costs in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." In accordance with GAAP, combined pension and postretirement cost for 2007 includes costs for BellSouth and AT&T Mobility employees, whereas 2006 does not. In the following table, gains are denoted with parentheses and losses are not.

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Pension cost:				
Service cost – benefits earned during the period	\$ 313	\$ 265	\$ 629	\$ 525
Interest cost on projected benefit obligation	807	626	1,608	1,254
Expected return on assets	(1,367)	(993)	(2,734)	(1,984)
Amortization of prior service cost	39	38	71	75
Recognized actuarial loss	60	87	120	180
Net pension cost (benefit)	\$ (148)	\$ 23	\$ (306)	\$ 50
Postretirement benefit cost:				
Service cost – benefits earned during the period	\$ 127	\$ 109	\$ 254	\$ 218
Interest cost on accumulated postretirement benefit obligation	644	478	1,287	972
Expected return on assets	(337)	(233)	(674)	(467)
Amortization of prior service benefit	(91)	(89)	(180)	(179)
Recognized actuarial loss	74	109	148	235
Postretirement benefit cost	\$ 417	\$ 374	\$ 835	\$ 779
Combined net pension and postretirement cost	\$ 269	\$ 397	\$ 529	\$ 829

Our combined net pension and postretirement cost decreased \$128 in the second quarter and \$300 for the first six months of 2007. Net pension and postretirement costs in 2007 reflect the December 2006 acquisition of BellSouth, which, due to the funded status of the BellSouth pension plans, increased the pension assets on which we calculate our expected return on plan assets of 8.5% to a greater degree than the additional service and interest costs. Also contributing to the decreased combined pension and postretirement cost were changes in our actuarial assumptions,

which included the increase of our discount rate from 5.75% to 6.00% (a decrease to expense) and recent favorable asset returns, which decreased the recognition of net losses.

In April 2007, we announced a one-time increase to certain retiree pension annuity payments, a weighted average increase of 2.9%. This pension adjustment is for pre-1996 retirees and increased our second quarter 2007 expense \$7.

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AT&T INC.
JUNE 30, 2007

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued

Dollars in millions except per share amounts

We have varying types of pension programs providing benefits for substantially all of certain non-U.S. operations. In addition to the pension and postretirement costs above, we recorded net pension cost for non-U.S. plans of \$4 in the second quarter and \$8 for the first six months of 2007 and \$6 in the second quarter and \$14 for the first six months of 2006.

We also provide senior- and middle-management retirees with nonqualified, unfunded supplemental retirement plans. Net supplemental retirement pension benefits cost, which is not included in the table above was \$49 in the second quarter and \$96 for the first six months of 2007, of which \$36 and \$72 was interest cost, respectively. Net supplemental retirement pension benefits cost was \$37 in the second quarter and \$75 for the first six months of 2006, of which \$27 and \$54 was interest cost, respectively. Additionally, in the second quarter of 2007, we recorded charges of \$21 due to accelerated benefit expenses and settlement charges related to retirements.

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AT&T INC.
JUNE 30, 2007

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

Dollars in millions except per share amounts

RESULTS OF OPERATIONS

For ease of reading, AT&T Inc. is referred to as “we,” “AT&T,” or the “Company” throughout this document and the names of the particular subsidiaries and affiliates providing the services generally have been omitted. AT&T is a holding company whose subsidiaries and affiliates operate in the communications services industry, both domestically and internationally, providing wireless and wireline communications services and equipment, managed networking, wholesale services and directory advertising and publishing services. You should read this discussion in conjunction with the consolidated financial statements, accompanying notes and management’s discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the year ended December 31, 2006. In the tables throughout this section, percentage increases and decreases that are not considered meaningful are denoted with a dash.

Consolidated Results We completed our acquisition of BellSouth Corporation (BellSouth) on December 29, 2006. We thereby acquired BellSouth’s 40% economic interest in AT&T Mobility LLC (AT&T Mobility), formerly Cingular Wireless LLC, resulting in 100% ownership of AT&T Mobility. In accordance with U.S. generally accepted accounting principles (GAAP), operating results for BellSouth and AT&T Mobility prior to our acquisition (i.e., all but the final two days of 2006) were not included in our 2006 operating results and are therefore not discussed. Accordingly, the following discussion of changes in our operating revenues and expenses is significantly affected by the BellSouth acquisition. Prior to the BellSouth acquisition, our 60% share of AT&T Mobility’s results was included in our net income and reported as equity in net income of affiliates. Our financial results in the second quarter and for the first six months of 2007 and 2006 are summarized as follows:

	Second Quarter			Six-Month Period		
	2007	2006	Percent Change	2007	2006	Percent Change
Operating revenues	\$ 29,478	\$ 15,770	86.9%	\$ 58,447	\$ 31,526	85.4%
Operating expenses	24,534	13,166	86.3	48,839	26,731	82.7
Operating income	4,944	2,604	89.9	9,608	4,795	-
Income before income taxes	4,402	2,697	63.2	8,870	4,854	82.7
Net Income	2,904	1,808	60.6	5,752	3,253	76.8

Overview

Operating income Our operating income increased \$2,340 in the second quarter and \$4,813 for the first six months, reflecting the addition of BellSouth’s and AT&T Mobility’s operating results as noted above, and our second quarter operating income margin increased from 16.5% in 2006 to 16.8% in 2007 and for the first six months increased from 15.2% in 2006 to 16.4% in 2007. Operating income increased primarily due to expense reduction through operational improvements, merger synergies and the addition of the higher-margined wireline operations at BellSouth, partially offset by merger-related charges and the additional amortization expense on intangibles identified and recorded in connection with the BellSouth and AT&T Corp. (ATTC) acquisitions.

Our operating income was slightly offset by the continued decline of our retail access lines due to increased competition, as customers disconnected both primary and additional lines and switched to competitors’ wireless, Voice over Internet Protocol (VoIP) and cable offerings for voice and data. While we lose the voice revenues, we have the opportunity to increase wireless service revenue should customers choose AT&T Mobility as their alternative

provider.

Operating revenues Our operating revenues increased \$13,708, or 86.9%, in the second quarter and \$26,921, or 85.4%, for the first six months primarily due to our acquisition of BellSouth and the resulting inclusion of BellSouth and AT&T Mobility revenues in our operating revenues. Also contributing to the operating revenue increase was continuing growth in data, primarily related to Internet Protocol (IP) data, partially offset by the continued decline in voice revenues. Wireless data growth at AT&T Mobility has also been strong and is expected to continue to contribute to overall revenue growth.

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AT&T INC.
JUNE 30, 2007

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

Dollars in millions except per share amounts

Operating expenses Our operating expenses increased \$11,368, or 86.3%, in the second quarter and \$22,108, or 82.7%, for the first six months of 2007 primarily due to the above-mentioned acquisition of BellSouth. Operating expenses included merger integration costs of \$320 in the second quarter and \$565 for the first six months, and amortization expense on intangible assets identified at the time of either the BellSouth or the ATTC acquisitions of \$1,567 in the second quarter and \$3,242 for the first six months. We are amortizing these intangibles using the sum-of-the-months-digits method, which means that we will record higher expenses in earlier periods. Partially offsetting these increases were merger synergies of approximately \$1,060 in the second quarter and \$1,960 for the first six months (of which \$250 and \$630, respectively, were capital), reflecting progress with the integration of BellSouth, AT&T Mobility and ATTC, force reductions and other cost-reduction initiatives.

Interest expense increased \$407, or 86.2%, in the second quarter and \$816, or 87.2%, for the first six months of 2007. The increase was primarily due to higher average debt balances resulting from the inclusion of BellSouth and AT&T Mobility outstanding debt on our consolidated balance sheet.

Interest income decreased \$56, or 58.9%, in the second quarter and \$106, or 58.9%, for the first six months of 2007. The decrease in interest income was primarily due to AT&T Mobility becoming a wholly-owned subsidiary of AT&T following the BellSouth acquisition. Prior to the acquisition of BellSouth, we reported interest income from AT&T Mobility, which borrowed funds from us under a shareholder loan and revolving credit agreement; this change also will negatively affect the remaining quarters of 2007.

Equity in net income of affiliates decreased \$245, or 53.8%, in the second quarter and \$406, or 51.5%, for the first six months of 2007. The decrease is primarily a result of the change in accounting for AT&T Mobility to a wholly-owned subsidiary. Prior to the BellSouth acquisition (see Note 2), we accounted for our 60% economic interest in AT&T Mobility under the equity method since we shared control equally with our joint-venture partner, BellSouth. As a result of the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary of AT&T and is reported in our wireless segment and our Consolidated Statements of Income. This decrease was slightly offset by an increase in results in our investments in América Móvil S.A. de C.V. (América Móvil) and Teléfonos de México, S.A. de C.V. (Telmex).

Other income (expense) – net We had other income of \$88 in the second quarter and \$557 for the first six months of 2007, as compared to other income of \$15 in the second quarter and \$26 for the first six months of 2006. Results in the second quarter of 2007 primarily included gains of \$80 related to the sale of administrative buildings and other non-strategic assets and \$64 for the sale of cost investments. These gains were partially offset by \$59 in minority interest expenses.

Results for the first six months of 2007 primarily included gains of \$409 related to a wireless spectrum license exchange, \$165 for the sale of administrative buildings and other non-strategic assets and \$64 for the sale of cost investments. These gains were partially offset by \$100 in minority interest expenses. Results for the first six months of 2006 included a gain of \$10 on the sale of shares of Covad Communications Group, Inc.

Income taxes increased \$609, or 68.5%, in the second quarter and \$1,517, or 94.8%, for the first six months of 2007. The increase in income taxes in the second quarter and for the first six months was primarily due to higher operating income in 2007 reflecting the addition of BellSouth's and its share of AT&T Mobility's operating results. Our effective tax rates were 34.0% in the second quarter of 2007 compared to 33.0% in the second quarter of 2006, and 35.2% for

the first six months of 2007 compared to 33.0% for the first six months of 2006. The increase in our effective tax rates in 2007 was primarily due to the consolidation of AT&T Mobility and an increase in income before income taxes. The effective tax rate for the second quarter of 2007 reflects a benefit related primarily to the enactment of state income tax legislation and the favorable resolution of a contested interest assessment.

AT&T INC.
JUNE 30, 2007

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

Dollars in millions except per share amounts

Selected Financial and Operating Data
(June 30, 2006 amounts do not include BellSouth)

	June 30,	
	2007	2006
Debt ratio ¹	35.6%	35.5%
In-region network access lines in service (000) ²	64,078	47,911
In-region wholesale lines (000) ²	4,342	4,913
In-region broadband connections (000) ^{2,3}	13,261	7,775
In-region video connections (000) ^{2,4}	1,897	590
In-region consumer revenue connections (000) ⁵	49,555	33,151
Number of AT&T employees	301,840	182,980
Wireless voice customers (000) ⁶	63,673	57,308

¹ See our "Liquidity and Capital Resources" section for discussion.

² In-region represents access lines served by AT&T's incumbent local exchange companies (ILECs).

³ Broadband connections include DSL lines of 13,203 in 2007 and 7,774 in 2006, U-verse high-speed Internet access and satellite broadband.

⁴ Video connections include customers that have satellite service under our agency and resale agreements with EchoStar and DIRECTV of 1,846 in 2007 and 590 in 2006 and U-verse video connections.

⁵ Consumer revenue connections include retail access lines, broadband and video.

⁶ Amounts represent 100% of the wireless customers of AT&T Mobility.