AT&T INC.
Form 10-Q
November 06, 2007

FORM 10-Q

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

(Mark One)

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

For the quarterly period ended September 30, 2007

or

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

For the transition period from to

Commission File Number 1-8610

AT&T INC.

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

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 October 29, 2007, common shares outstanding were 6,064,758,808.

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 September 30,		Nine months ended September 30,	
	2007	2006	**2007**	2006
Operating Revenues				
Voice	**$ 10,164**	$ 8,400	**$ 30,997**	$ 25,524
Data	**5,880**	4,598	**17,281**	13,633
Wireless service	**9,834**	8	**28,417**	24
Directory	**1,240**	906	**3,417**	2,716
Other	**3,014**	1,726	**8,467**	5,267
Total operating revenues	**30,132**	15,638	**88,579**	47,164
Operating Expenses				
Cost of sales (exclusive of depreciation and amortization shown separately below)	**11,591**	6,923	**34,321**	21,450
Selling, general and administrative	**7,915**	3,361	**22,992**	10,587
Depreciation and amortization	**5,322**	2,437	**16,354**	7,415
Total operating expenses	**24,828**	12,721	**73,667**	39,452
Operating Income	**5,304**	2,917	**14,912**	7,712
Other Income (Expense)				
Interest expense	**(887)**	(442)	**(2,639)**	(1,378)
Equity in net income of affiliates	**162**	649	**545**	1,438
Other income (expense) – net	**(17)**	109	**614**	315
Total other income (expense)	**(742)**	316	**(1,480)**	375
Income Before Income Taxes	**4,562**	3,233	**13,432**	8,087
Income taxes	**1,499**	1,068	**4,617**	2,669
Net Income	**$ 3,063**	$ 2,165	**$ 8,815**	$ 5,418
Earnings Per Common Share				
Net Income	**$ 0.50**	$ 0.56	**$ 1.43**	$ 1.40
Earnings Per Common Share - Assuming Dilution				
Net Income	**$ 0.50**	$ 0.56	**$ 1.42**	$ 1.39
Weighted Average Number of Common Shares Outstanding – Basic (in millions)	**6,088**	3,873	**6,152**	3,880
Dividends Declared Per Common Share	**$ 0.3550**	$ 0.3325	**$ 1.065**	$ 0.9975

See Notes to Consolidated Financial Statements.

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

Assets	September 30, 2007 (Unaudited)	December 31, 2006
Current Assets		
Cash and cash equivalents	$ 2,714	$ 2,418
Accounts receivable – net of allowances for uncollectibles of $1,362 and $1,276	16,305	16,194
Prepaid expenses	1,900	1,477
Deferred income taxes	2,433	3,034
Other current assets	2,191	2,430
Total current assets	25,543	25,553
Property, plant and equipment	206,818	202,149
Less: accumulated depreciation and amortization	112,372	107,553
Property, Plant and Equipment – Net	94,446	94,596
Goodwill	66,847	67,657
Licenses	35,687	34,252
Customer Lists and Relationships – Net	15,361	18,922
Other Intangible Assets – Net	6,001	6,566
Investments in Equity Affiliates	2,403	1,995
Postemployment Benefit	14,779	14,228
Other Assets	6,901	6,865
Total Assets	$ 267,968	$ 270,634
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	$ 6,026	$ 9,733
Accounts payable and accrued liabilities	20,239	22,106
Advanced billing and customer deposits	3,471	3,402
Accrued taxes	6,282	3,026
Dividends payable	2,156	2,215
Total current liabilities	38,174	40,482
Long-Term Debt	54,585	50,063
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	22,595	27,406
Postemployment benefit obligation	28,756	28,901
Unamortized investment tax credits	158	181
Other noncurrent liabilities	12,526	8,061
Total deferred credits and other noncurrent liabilities	64,035	64,549
Stockholders' Equity		
Common shares issued ($1 par value)	6,495	6,495
Capital in excess of par value	91,534	91,352
Retained earnings	32,606	30,375
Treasury shares (at cost)	(14,411)	(7,368)
Accumulated other comprehensive income	(5,050)	(5,314)
Total stockholders' equity	111,174	115,540
Total Liabilities and Stockholders' Equity	$ 267,968	$ 270,634

See Notes to Consolidated Financial Statements.

AT&T INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Dollars in millions, increase (decrease) in cash and cash equivalents
(Unaudited)

	Nine months ended September 30, 2007	2006
Operating Activities		
Net income	**$ 8,815**	$ 5,418
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**16,354**	7,415
Undistributed earnings from investments in equity affiliates	**(434)**	(1,359)
Provision for uncollectible accounts	**1,142**	450
Amortization of investment tax credits	**(23)**	(21)
Deferred income tax (benefit) expense	**486**	(269)
Net gain on sales of investments	**(29)**	(10)
Gain on license exchange	**(409)**	-
Changes in operating assets and liabilities:		
Accounts receivable	**(1,253)**	249
Other current assets	**(661)**	42
Accounts payable and accrued liabilities	**(46)**	(1,819)
Stock-based compensation tax benefit	**(149)**	(10)
Other - net	**427**	507
Total adjustments	**15,405**	5,175
Net Cash Provided by Operating Activities	**24,220**	10,593
Investing Activities		
Construction and capital expenditures	**(12,124)**	(6,158)
Net investments in affiliates	**-**	(633)
Dispositions	**993**	72
Acquisitions, net of cash acquired	**(233)**	(115)
Proceeds from sale of marketable securities	**471**	-
Proceeds from sale of debt and equity securities	**414**	-
Investments in debt and equity securities	**(301)**	-
Other	**28**	8
Net Cash Used in Investing Activities	**(10,752)**	(6,826)
Financing Activities		
Net change in short-term borrowings with original maturities of three months or less	**(4,279)**	2,336
Issuance of long-term debt	**7,898**	1,491
Repayment of long-term debt	**(3,008)**	(2,882)
Purchase of treasury shares	**(8,912)**	(1,359)
Issuance of treasury shares	**1,736**	463
Dividends paid	**(6,584)**	(3,873)
Stock-based compensation tax benefit	**149**	10
Other	**(172)**	74
Net Cash Used in Financing Activities	**(13,172)**	(3,740)
Net increase in cash and cash equivalents	**296**	27
Cash and cash equivalents beginning of year	**2,418**	1,224

Cash and Cash Equivalents End of Period	**$**	**2,714**	$	1,251
Cash paid during the nine months ended September 30 for:				
Interest	**$**	**2,518**	$	1,503
Income taxes, net of refunds	**$**	**2,028**	$	2,249

See Notes to Consolidated Financial Statements.

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

	Nine months ended September 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		**$**	**91,352**
Issuance of shares			**134**
Stock based compensation			**48**
Balance at end of period		**$**	**91,534**
Retained Earnings			
Balance at beginning of year		**$**	**30,375**
Net income ($1.42 per diluted share)			**8,815**
Dividends to stockholders ($1.065 per share)			**(6,525)**
Adoption of FIN 48			**(50)**
Other			**(9)**
Balance at end of period		**$**	**32,606**
Treasury Shares			
Balance at beginning of year	**(256)**	**$**	**(7,368)**
Purchase of shares	**(230)**		**(8,912)**
Issuance of shares	**63**		**1,869**
Balance at end of period	**(423)**	**$**	**(14,411)**
Accumulated Other Comprehensive Income, net of tax			
Balance at beginning of year		**$**	**(5,314)**
Purchase accounting adjustment to apply FAS 158, net of tax			**46**
Other comprehensive income (loss) (see Note 3)			**218**
Balance at end of period		**$**	**(5,050)**

See Notes to Consolidated Financial Statements .

AT&T INC.
SEPTEMBER 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 Forms 10-Q 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,” (FAS 112) 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 September 30, 2007, we had severance accruals under FAS 112 of $156, of which $132 was established as merger-related severance accruals. At December 31, 2006, we had severance accruals of $263.

New Accounting Standards
FIN 48 We adopted Financial Accounting Standards Board (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 the first quarter. 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 which $1,913 would favorably affect income tax expense in future periods. The $1,913 is net of related deferred tax assets. During the third quarter, we reduced our unrecognized tax benefits by $390. The significant components of the reduction were a decrease of $261 as a result of settlement of an Internal Revenue Service (IRS) audit, a decrease of $229 due to a change in management's measurement of benefits related to capital losses claimed on our 2002 tax return, and an increase of $116 due to interest accruals and current period unrecognized tax benefits. The total amount of unrecognized tax benefits including interest and penalties at September 30, 2007 was $5,791, of which $4,136 was included in "Other noncurrent liabilities" and $1,655 was included in "Accrued taxes" on our Consolidated Balance Sheets. Of our total unrecognized tax benefits balance of $5,791, we expect to pay $1,655 within one year. We cannot reasonably estimate the timing or amounts of additional cash payments, if any, at this time. Of the September 30, 2007 balance, $1,909 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 $1,364 as of January 1, 2007 and September 30, 2007, respectively.

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 through 2002 and all audit periods prior to 1998 are closed for federal purposes. We were unable to reach agreement with the IRS on one issue related to our 1998 and 1999 tax returns and, as a result, we have filed a refund suit in U.S. District Court. We have withdrawn from the IRS "Expedited Resolution of Uncertain Tax Positions Initiative" with regard to capital losses claimed on our 2002 tax returns and have requested that this issue be included in the IRS Appeals Division (Appeals) settlement meetings regarding our 2000-2002 returns. We may reach a resolution of this examination cycle during the next twelve months but, at this time, we are not able to determine the impact that resolution may have on our unrecognized tax benefits. The IRS is currently examining the AT&T 2003-2005 tax returns, and we expect their fieldwork to be completed during 2008.

The IRS has completed the examination of all acquired entity tax returns through 2003 (AT&T Corp. through 2004) and, with the exception of BellSouth, all years through 2001 are closed. We expect to settle the AT&T Corp. 2005 examination within the next twelve months with an immaterial impact on our unrecognized tax benefits. 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.

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.

EITF 06-11 In June 2007, the Emerging Issues Task Force (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.

AT&T INC.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
Dollars in millions except per share amounts

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 nine months of 2007.

	BellSouth Purchase Price Allocation		
	As of 12/31/06	Adjustments	As of 9/30/07
Assets acquired			
Current assets	$ 4,875	$ 42	$ 4,917
Property, plant and equipment	18,498	249	18,747
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	(92)	26,375
Total assets acquired	106,341	344	106,685
Liabilities assumed			
Current liabilities, excluding current portion of long-term debt	5,288	(528)	4,760
Long-term debt	15,628	(4)	15,624
Deferred income taxes	10,318	797	11,115
Postemployment benefit obligation	7,086	(70)	7,016
Other noncurrent liabilities	1,223	128	1,351
Total liabilities assumed	39,543	323	39,866
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 nine months of 2007.

	Fair Value Adjustments AT&T Mobility		
	As of 12/31/06	Adjustments	As of 9/30/07
Assets acquired			
Current assets	$ 6,988	$ 3	$ 6,991
Property, plant and equipment	19,687	(411)	19,276
Intangible assets not subject to amortization:			
Licenses	33,979	887	34,866
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	(377)	27,052
Total assets acquired	97,271	412	97,683
Liabilities assumed			
Current liabilities, excluding current portion of long-term debt	7,014	384	7,398
Intercompany debt	9,043	-	9,043
Long-term debt	12,559	-	12,559
Deferred income taxes	5,459	71	5,530
Postemployment benefit obligation	301	93	394
Other noncurrent liabilities	2,007	(92)	1,915
Total liabilities assumed	36,383	456	36,839
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.

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AT&T INC.
SEPTEMBER 30, 2007

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

Valuation and Other Adjustments
As AT&T Corp. (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 September 30, 2007, we had recorded $8 in related goodwill reductions for ATTC and $28 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 2007, we recorded additional accruals for severance, 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 nine 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.	9/30/07 Balance
Severance accruals paid from:					
Company funds	$ 986	$ (348)	$ 16	$ (72)	$ 582
Pension and postemployment benefit plans	183	(39)	-	-	144
Lease terminations	146	(72)	220	24	318
Equipment removal and other related costs	117	(110)	152	(28)	131
Total	$ 1,432	$ (569)	$ 388	$ (76)	$ 1,175

AT&T INC.
SEPTEMBER 30, 2007

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 nine months ended September 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 September 30,		Nine months ended September 30,	
	2007	2006	**2007**	2006
Net income	**$ 3,063**	$ 2,165	**$ 8,815**	$ 5,418
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	**(14)**	29	**4**	(16)
Net unrealized gains (losses) on securities:				
Unrealized gains (losses)	**(15)**	(17)	**134**	17
Reclassification adjustment for gains realized in net income	**3**	-	**(37)**	(8)
Net unrealized gains (losses) on cash flow hedges:				
Unrealized gains (losses)	**(15)**	-	**(51)**	2
Reclassification adjustment for losses realized in net income	**5**	4	**13**	12
Defined benefit postretirement plans:				
Amortization of net actuarial loss included in net income	**87**	-	**262**	-
Amortization of prior service benefit included in net income	**(35)**	-	**(106)**	-
Other	**-**	-	**(1)**	1
Other comprehensive income	**16**	16	**218**	8
Total Comprehensive Income	**$ 3,079**	$ 2,181	**$ 9,033**	$ 5,426

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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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 nine months ended September 30, 2007 and 2006 is shown in the table below:

	Three months ended September 30,		Nine months ended September 30,	
	2007	2006	**2007**	2006
Numerators				
Numerator for basic earnings per share:				
Income from continuing operations	**$ 3,063**	$ 2,165	**$ 8,815**	$ 5,418
Dilutive potential common shares:				
Other stock-based compensation	**2**	2	**6**	5
Numerator for diluted earnings per share	**$ 3,065**	$ 2,167	**$ 8,821**	$ 5,423
Denominators (000,000)				
Denominator for basic earnings per share:				
Weighted-average number of common shares outstanding	**6,088**	3,873	**6,152**	3,880
Dilutive potential common shares:				
Stock options	**26**	5	**25**	4
Other stock-based compensation	**15**	14	**19**	16
Denominator for diluted earnings per share	**6,129**	3,892	**6,196**	3,900
Basic earnings per share				
Net income	**$ 0.50**	$ 0.56	**$ 1.43**	$ 1.40
Diluted earnings per share				
Net income	**$ 0.50**	$ 0.56	**$ 1.42**	$ 1.39

At September 30, 2007, we had issued and outstanding options to purchase approximately 241 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 73 million shares in the third quarter and 100 million for the first nine 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 September 30, 2006, we had issued and outstanding options to purchase 234 million shares of AT&T common stock. The exercise prices of options to purchase a weighted average of 189 million shares in the third quarter and 212 million for the first nine 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 September 30, 2007, the exercise price of 169 million share options was below market price.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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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-verse^{sm} TV service (U-verse) and satellite television services through our agency 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 $196 in the third quarter and $911 for the first nine months and expenses of $64 in the third quarter and $291 for the first nine 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 &

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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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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For the three months ended September 30, 2007

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	$ 17,471	$ 10,911	$ 1,436	$ 510	$ (196)	$ 30,132
Intersegment revenues	469	26	21	52	(568)	-
Total segment operating revenues	17,940	10,937	1,457	562	(764)	30,132
Operations and support expenses	11,725	7,262	755	399	(635)	19,506
Depreciation and amortization expenses	3,333	1,709	238	41	1	5,322
Total segment operating expenses	15,058	8,971	993	440	(634)	24,828
Segment operating income	2,882	1,966	464	122	(130)	5,304
Interest expense	-	-	-	-	887	887
Equity in net income (loss) of affiliates [1]	-	(40)	-	159	43	162
Other income (expense) – net	-	-	-	-	(17)	(17)
Segment income before income taxes	$ 2,882	$ 1,926	$ 464	$ 281	$ (991)	$ 4,562

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

At September 30, 2007 or for the nine months ended

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Consolidated Results
Revenues from external customers	$ 52,425	$ 31,254	$ 4,328	$ 1,483	$ (911)	$ 88,579
Intersegment revenues	1,494	75	50	181	(1,800)	-
Total segment operating revenues	53,919	31,329	4,378	1,664	(2,711)	88,579
Operations and support expenses	34,958	20,826	2,281	1,340	(2,092)	57,313
Depreciation and amortization expenses	10,073	5,410	743	128	-	16,354
Total segment operating expenses	45,031	26,236	3,024	1,468	(2,092)	73,667

Segment operating income		**8,888**		**5,093**		**1,354**		**196**		**(619)**		**14,912**
Interest expense		**-**		**-**		**-**		**-**		**2,639**		**2,639**
Equity in net income (loss) of affiliates [1]		**-**		**(131)**		**-**		**533**		**143**		**545**
Other income (expense) – net		**-**		**-**		**-**		**-**		**614**		**614**
Segment income before income taxes	**$**	**8,888**	**$**	**4,962**	**$**	**1,354**	**$**	**729**	**$**	**(2,501)**	**$**	**13,432**
Segment Assets	**$**	**170,477**	**$**	**96,158**	**$**	**9,508**	**$**	**172,455**	**$**	**(180,630)**	**$**	**267,968**

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

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For the three months ended September 30, 2006

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	$ 14,305	$ 9,561	$ 907	$ 418	$ -	$ (9,553)	$ 15,638
Intersegment revenues	1	-	6	51	(58)	-	-
Total segment operating revenues	14,306	9,561	913	469	(58)	(9,553)	15,638
Operations and support expenses	9,563	6,561	431	349	(59)	(6,561)	10,284
Depreciation and amortization expenses	2,387	1,582	1	42	2	(1,577)	2,437
Total segment operating expenses	11,950	8,143	432	391	(57)	(8,138)	12,721
Segment operating income	2,356	1,418	481	78	(1)	(1,415)	2,917
Interest expense	-	-	-	-	442	-	442
Equity in net income (loss) of affiliates [1]	-	(36)	(2)	644	1	42	649
Other income (expense) – net	-	-	-	-	109	-	109
Segment income before income taxes	$ 2,356	$ 1,382	$ 479	$ 722	$ (333)	$ (1,373)	$ 3,233

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

For the nine months ended September 30, 2006

	Wireline	Wireless	Advertising & Publishing	Other	Consolidation and Elimination	Wireless Elimination	Consolidated Results
Revenues from external customers	$ 43,161	$ 27,774	$ 2,716	$ 1,263	$ -	$ (27,750)	$ 47,164
Intersegment revenues	2	-	30	127	(159)	-	-
Total segment operating revenues	43,163	27,774	2,746	1,390	(159)	(27,750)	47,164
	29,888	19,657	1,298	1,010	(159)	(19,657)	32,037

Operations and support expenses							
Depreciation and amortization expenses	7,266	4,874	2	127	-	(4,854)	7,415
Total segment operating expenses	37,154	24,531	1,300	1,137	(159)	(24,511)	39,452
Segment operating income	6,009	3,243	1,446	253	-	(3,239)	7,712
Interest expense	-	-	-	-	1,378	-	1,378
Equity in net income (loss) of affiliates [1]	-	(99)	(13)	1,421	2	127	1,438
Other income (expense) – net	-	-	-	-	315	-	315
Segment income before income taxes	$ 6,009	$ 3,144	$ 1,433	$ 1,674	$ (1,061)	$ (3,112)	$ 8,087

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

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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 September 30,		Nine months ended September 30,	
	2007	2006	**2007**	2006
Pension cost:				
Service cost – benefits earned during the period	**$ 314**	$ 262	**$ 943**	$ 787
Interest cost on projected benefit obligation	**803**	627	**2,411**	1,881
Expected return on assets	**(1,367)**	(1,008)	**(4,101)**	(2,992)
Amortization of prior service cost	**36**	37	**107**	112
Recognized actuarial loss	**61**	91	**181**	271
Net pension cost (benefit)	**$ (153)**	$ 9	**$ (459)**	$ 59
Postretirement benefit cost:				
Service cost – benefits earned during the period	**$ 127**	$ 108	**$ 381**	$ 326
Interest cost on accumulated postretirement benefit obligation	**644**	485	**1,931**	1,457
Expected return on assets	**(336)**	(234)	**(1,010)**	(701)
Amortization of prior service benefit	**(90)**	(90)	**(270)**	(269)
Recognized actuarial loss	**72**	119	**220**	354
Postretirement benefit cost	**$ 417**	$ 388	**$ 1,252**	$ 1,167
Combined net pension and postretirement cost	**$ 264**	$ 397	**$ 793**	$ 1,226

Our combined net pension and postretirement cost decreased $133 in the third quarter and $433 for the first nine 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.

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 $3 in the third quarter and $11 for the nine months of 2007 and $4 in the third quarter and $18 for the first nine months of 2006.

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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 $50 in the third quarter and $146 for the first nine months of 2007, of which $37 and $109 was interest cost, respectively. Net supplemental retirement pension benefits cost was $38 in the third quarter and $113 for the first nine months of 2006, of which $26 and $77 was interest cost, respectively.

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

For ease of reading, AT&T Inc. is referred to as "we," "AT&T," or the "Company" throughout this document and the names of the particular subsidiaries and affiliates providing the services generally have been omitted. AT&T is a holding company whose subsidiaries and affiliates operate in the communications services industry, 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 third quarter and for the first nine months of 2007 and 2006 are summarized as follows:

	Third Quarter			Nine-Month Period		
	2007	2006	Percent Change	**2007**	2006	Percent Change
Operating revenues	**$ 30,132**	$ 15,638	92.7%	**$ 88,579**	$ 47,164	87.8%
Operating expenses	**24,828**	12,721	95.2	**73,667**	39,452	86.7
Operating income	**5,304**	2,917	81.8	**14,912**	7,712	93.4
Income before income taxes	**4,562**	3,233	41.1	**13,432**	8,087	66.1
Net Income	**3,063**	2,165	41.5	**8,815**	5,418	62.7

Overview

Operating income Our operating income increased $2,387 in the third quarter and $7,200 for the first nine months, reflecting the addition of BellSouth's and AT&T Mobility's operating results as noted above. Our operating income margin decreased in the third quarter from 18.7% in 2006 to 17.6% in 2007 and increased for the first nine months from 16.4% in 2006 to 16.8% in 2007. The third quarter of 2006 reflected expense reductions due to a change in our vacation policy. Results for the quarter and nine months ended reflected merger-related charges and the additional amortization expense on intangibles identified and recorded in connection with the BellSouth and AT&T Corp. (ATTC) acquisitions, non-merger severance and non-recurring adjustments, partially offset by operational improvements, merger synergies and the addition of the higher-margined wireline operations at BellSouth. As we amortize several merger-related intangible assets using the sum-of-the-months-digits method of amortization, amortization expense decreases as the amount of time we hold the assets increases.

The positive impact of the BellSouth acquisition 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 $14,494, or 92.7%, in the third quarter and $41,415, or 87.8%, for the first nine months primarily due to our acquisition of BellSouth and the resulting inclusion of BellSouth and wireless 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 has also been strong and is expected to continue.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation - Continued
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Operating expenses Our operating expenses increased $12,107, or 95.2%, in the third quarter and $34,215, or 86.7%, for the first nine months of 2007 primarily due to the above-mentioned acquisition of BellSouth. Operating expenses included merger integration costs of $326 in the third quarter and $891 for the first nine months, and amortization expense on intangible assets identified at the time of either the BellSouth or the ATTC acquisitions of $1,365 in the third quarter and $4,607 for the first nine 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 $670 in the third quarter and $2,000 for the first nine months, reflecting progress with the integration of BellSouth, AT&T Mobility and ATTC, workforce reductions and other cost-reduction initiatives.

Interest expense increased $445 in the third quarter and $1,261, or 91.5%, for the first nine 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.

Equity in net income of affiliates decreased $487, or 75.0%, in the third quarter and $893, or 62.1%, for the first nine months of 2007. The decrease is 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 improved results from 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 expense of $17 in the third quarter and other income of $614 for the first nine months of 2007, as compared to other income of $109 in the third quarter and $315 for the first nine months of 2006. Results in the third quarter of 2007 primarily included $43 in minority interest expenses and $24 from the loss on sale of cost investments, partially offset by interest income of $44. Results in the third quarter of 2006 primarily consisted of $98 of interest income, $14 related to leveraged lease and royalty income and other expenses of $5 related to fair value adjustments on financial instruments.

Results for the first nine months of 2007 primarily included gains of $409 related to a wireless spectrum license exchange, $127 for the sale of administrative buildings and other non-strategic assets, $118 of interest income and $29 for the sale of cost investments. These gains were partially offset by $143 in minority interest expenses.

Results for the first nine months of 2006 primarily consisted of interest income of $278, royalty income of $15, a gain of $10 on the sale of shares of Covad Communications Group, Inc, and leveraged lease income of $8. These gains were partially offset by other expenses of $20 related to fair value adjustments on financial instruments and net exchange rate losses.

Income taxes increased $431, or 40.4%, in the third quarter and $1,948, or 73.0%, for the first nine months of 2007. The increase in income taxes in the third quarter and for the first nine 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 32.9% in the third quarter of 2007 compared to 33.0% in the third quarter of 2006, and 34.4% for the first nine months of 2007 compared to 33.0% for the first nine months of 2006. The increase in our effective tax rate for the first nine months of 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 third quarter of 2007 reflects a benefit related primarily to adjustments to our unrecognized tax benefits partially offset by the impact of a state law change.

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

	September 30,	
	2007	2006
Wireless customers (000)[1]	**65,666**	58,666
In-region consumer revenue connections (000)[2,7]	**49,639**	33,197
In-region network access lines in service (000)[3]	**62,871**	47,087
In-region wholesale lines (000)[3,7]	**3,849**	4,493
In-region broadband connections (000)[3,4,7]	**13,760**	8,155
In-region video connections (000)[3,5,7]	**2,112**	643
Debt ratio[6]	**35.3%**	36.3%
Number of AT&T employees	**303,670**	179,420

[1] Amounts represent 100% of the wireless customers of AT&T Mobility.
[2] Consumer revenue connections include retail access lines, broadband and video.
[3] In-region represents access lines served by AT&T's incumbent local exchange companies (ILECs).
[4] Broadband connections include DSL, U-verse high speed Internet access and satellite broadband.
[5] Video connections include customers that have satellite service under our agency and resale agreements with EchoStar and DIRECTV and U-verse video connections.
[6] See our "Liquidity and Capital Resources" section for discussion.
[7] Prior year amounts restated to conform to current year methodology.

Supplemental Information
To provide improved comparability versus previous results, below is a supplemental table providing pro forma consolidated operating revenues assuming the closing date for the BellSouth acquisition was January 1, 2005.

Supplemental Consolidated Operating Revenues Information

	Third Quarter			Nine-Month Period		
	Actual 2007	Pro Forma 2006	Percent Change	**Actual 2007**	Pro Forma 2006	Percent Change
Segment operating revenues						
Voice	**$ 10,164**	$ 10,850	(6.3)%	**$ 30,997**	$ 32,955	(5.9)%
Data	**5,880**	5,579	5.4	**17,281**	16,521	4.6
Wireless service	**9,834**	8,646	13.7	**28,417**	24,910	14.1
Directory	**1,240**	1,456	(14.8)	**3,417**	4,332	(21.1)
Other	**3,014**	2,861	5.3	**8,467**	8,778	(3.5)
Total Operating Revenues	**$ 30,132**	$ 29,392	2.5%	**$ 88,579**	$ 87,496	1.2%

The pro forma voice revenue decline is consistent with trends in recent quarters and is due to access line declines reflecting competition and substitution of alternative technologies, pricing pressures due to competition, anticipated shifts of traffic by major consolidated carriers to their own networks and a continuing decline in the number of ATTC's mass-market customers, which represent consumer and small business.

Pro forma data growth was led by an increase in IP data revenues of 12.8% in the third quarter and 12.1% for the first nine months of 2007, with strength in high speed Internet, managed Internet, Virtual Private Network (VPN) and hosting services. Data transport service revenues were up 0.8% in the third quarter and 1.4% for the first nine months, and packet switched data revenues, which include frame relay and asynchronous transfer mode (ATM) services, were down 5.4% and 6.6%, respectively, consistent with industry trends and results of recent quarters.

Pro forma wireless service growth was driven by subscriber growth and strong increases in data usage, including increased messaging, browsing, downloads, media bundles and laptop and smart phone connectivity. Since we have historically discussed our wireless segment results on a basis that included 100% of AT&T Mobility results, a detailed wireless service revenue discussion can be found in our “Wireless segment results” section.

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Pro forma directory results are lower in 2007 due to the purchase accounting treatment of directories delivered by BellSouth's advertising and publishing businesses in the 12 months prior to the merger (see Note 5). In accordance with GAAP, the deferred revenues from these books were not included in the opening balance sheet and are therefore not included in the 2007 directory revenues. Had those deferred revenues been included in 2007, directory revenues would have increased by $196 in the third quarter and $911 for the first nine months.

Pro forma other revenues are higher in the third quarter reflecting improved wireless handset sales, and lower for the first nine months in 2007 due to a decline in demand for integration services and customer premises equipment.

Segment Results
Our segments represent strategic business units that offer different products and services and are managed accordingly. Our operating segment results presented in Note 5 and discussed below for each segment follow our internal management reporting. 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. As a result of our 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, IP and Internet access data, messaging services, managed networking to business customers, AT&T U-verse^{sm} TV services (U-verse) and satellite television services through our agency agreements with EchoStar Communications Corp. (Echostar or "AT&T | DISH Network" offering) and the DIRECTV Group, Inc. (DIRECTV).

The wireless segment provides voice, data and other wireless communications services, and reflects 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 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 YELLOWPAGES.COM (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. In 2006, our portion of the results from YPC were recorded in this segment as equity in net income of affiliates. Our advertising & publishing segment results include revenue of $196 in the third quarter and $911 for the first nine months and expenses of $64 in the third quarter and $291 for the first nine months of 2007, related to directories published in the Southeast region during 2006, prior to our acquisition of BellSouth (see Note 5).

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

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The following tables show components of results of operations by segment. A discussion of significant segment results is also presented following each table. Capital expenditures for each segment are discussed in "Liquidity and Capital Resources."

Wireline
Segment Results

	Third Quarter			Nine-Month Period		
	2007	2006	Percent Change	**2007**	2006	Percent Change
Segment operating revenues						
Voice	**$ 10,356**	$ 8,400	23.3%	**$ 31,619**	$ 25,524	23.9%
Data	**6,076**	4,598	32.1	**17,918**	13,633	31.4
Other	**1,508**	1,308	15.3	**4,382**	4,006	9.4
Total Segment Operating Revenues	**17,940**	14,306	25.4	**53,919**	43,163	24.9
Segment operating expenses						
Cost of sales	**7,620**	6,495	17.3	**22,801**	20,072	13.6
Selling, general and administrative	**4,105**	3,068	33.8	**12,157**	9,816	23.8
Depreciation and amortization	**3,333**	2,387	39.6	**10,073**	7,266	38.6
Total Segment Operating Expenses	**15,058**	11,950	26.0	**45,031**	37,154	21.2
Segment Income	**$ 2,882**	$ 2,356	22.3%	**$ 8,888**	$ 6,009	47.9%

Operating Income and Margin Trends
Our wireline segment operating income increased $526 in the third quarter and $2,879 for the first nine months reflecting the addition of BellSouth's operating results in 2007. Our wireline segment operating income margin decreased in the third quarter from 16.5% in 2006 to 16.1% in 2007 and increased for the first nine months from 13.9% in 2006 to 16.5% in 2007. Our third-quarter expenses reflect charges related to legal proceedings, contract termination and severance charges. Results for the third quarter and nine months ended reflect lower expenses as a result of merger synergies and the addition of higher-margined operations of BellSouth, partially offset by merger-related charges and additional amortization expense on those intangibles identified at the time of our acquisitions of BellSouth and ATTC. Our operating income continued to be pressured by access line declines due to increased competition, as customers disconnected both primary and additional lines and switched to alternative technologies, such as wireless, VoIP and cable for voice and data. Our strategy is to offset these line losses by increasing non-access-line-related revenues from customer connections for data, video and voice. For example, we have the opportunity to increase wireless segment revenues if customers choose AT&T Mobility as an alternative provider.

Wireline Operating Results
All changes other than those specifically stated as being due to the BellSouth acquisition are related to pre-acquisition wireline operations.

Voice revenues increased $1,956, or 23.3%, in the third quarter of 2007 and $6,095, or 23.9%, for the first nine months of 2007 primarily due to the acquisition of BellSouth. Included in voice revenues are revenues from local voice, long-distance and local wholesale services. Voice revenues do not include VoIP revenues, which are included in data revenues.

- Local voice revenues increased $1,661, or 37.4%, in the third quarter and $5,230, or 39.1%, for the first nine months of 2007 due to the acquisition of BellSouth, which increased local voice revenues approximately $1,990 in the third quarter and $6,070 for the first nine months of 2007. Local voice revenues also increased in the third quarter due to pricing increases for regional telephone service, custom calling features and inside wire maintenance agreements. These increases were partially offset by expected declines in revenues from ATTC's mass-market customers to which no proactive marketing occurs. Local voice revenues were also negatively impacted by continued declines in customer demand for sales of calling features and inside wire agreements. We expect our local voice revenue to continue to be negatively affected by increased competition, including customers shifting to competitors' alternative technology and the disconnection of additional lines for DSL service and other reasons.

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- Long-distance revenues increased $230, or 6.4%, in the third quarter and $594, or 5.4%, for the first nine months of 2007 due to the acquisition of BellSouth, which increased long-distance revenues approximately $535 and $1,555 respectively. Contributing to the increases were continuing higher long-distance penetration levels in our original 13 states in the third quarter. These increases were primarily offset by a continuing decrease in demand for long-distance service, mostly due to an expected decline in ATTC's mass-market customers, mentioned previously. Our long-distance revenue increase was also partially offset in the third quarter by competitive pricing for large-business customers and a decrease in demand for prepaid calling cards.
    - Local wholesale revenues increased $65, or 17.2%, in the third quarter and $271, or 23.1%, for the first nine months of 2007 primarily due to the acquisition of BellSouth, which increased local wholesale revenues approximately $150 in the third quarter and $470 for the first nine months. This increase was partially offset by lower demand for local wholesale services primarily due to the decreased demand for resold lines provided to competitors. However, this decrease in demand for our local wholesale lines was partially offset by price increases as we negotiate long-term contracts.

Data revenues increased $1,478, or 32.1%, in the third quarter and $4,285, or 31.4%, for the first nine months of 2007. Data revenues accounted for approximately 33% of our wireline operating revenues in the third quarter and for the first nine months of 2007 and over 31% of wireline operating revenues in the third quarter and for the first nine months of 2006. Data revenues include transport, IP and packet switched data services.

IP data revenues increased $779, or 47.4%, in the third quarter and $2,213, or 46.3%, for the first nine months of 2007, primarily due to the acquisition of BellSouth, which increased IP data approximately $565 and $1,640, respectively. Included in IP data revenues are DSL, dedicated Internet access, VPN and other hosting services. VPN and dedicated Internet access services contributed to IP data growth in 2007 due to continued growth in the customer base and migration from other traditional circuit-based products.

Our transport services, which include DS1s and DS3s (types of dedicated high-capacity lines) and SONET (a dedicated high-speed solution for multi-site businesses), increased $679, or 30.7%, in the third quarter and $2,031, or 30.7%, for the first nine months of 2007, almost entirely due to the acquisition of BellSouth.

Our packet switched services, which include frame relay, ATM and managed packet services, increased $20, or 2.7%, in the third quarter and $41, or 1.8%, for the first nine months of 2007 primarily due to the acquisition of BellSouth, which increased packet switched services revenue approximately $80 in the third quarter and $205 for the first nine months of 2007. This increase was almost entirely offset by both competitive pricing and lower demand as customers continue to shift to IP-based technology. We expect these services to continue to decline as a percentage of our overall data revenues.

Other operating revenues increased $200, or 15.3%, in the third quarter and $376, or 9.4%, for the first nine months of 2007, due to our acquisition of BellSouth, which increased other operating revenue approximately $220 in the third quarter and $680 for the first nine months. Major items included in other operating revenues are integration services and customer premises equipment, government-related services, state and municipal fees, outsourcing and international data bundles, which account for over 76% of total other operating revenue for all periods. Equipment sales and related network integration and management services decreased $29 in the third quarter and $205 for the first nine months primarily due to less emphasis on the sale of lower-margin equipment. Revenue also decreased by

$70 for the first nine months of 2007 due to the recognition of intellectual property license fees in 2006.

Cost of sales expenses increased $1,125, or 17.3%, in the third quarter and $2,729, or 13.6%, for the first nine months of 2007, due to the acquisition of BellSouth, which increased expenses approximately $1,160 in the third quarter and $3,570 for the first nine months. Cost of sales consists

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of costs we incur in order to provide our products and services, including costs of operating and maintaining our networks. Costs in this category include our repair technicians and repair services, certain network planning and engineering expenses, operator services, information technology and property taxes related to elements of our network. Pension and postretirement costs, net of amounts capitalized as part of construction labor, are also included to the extent that they are allocated to our network labor force and other employees who perform the functions listed in this paragraph.

In addition to the impact of the BellSouth acquisition, cost of sales in 2007 increased due to the following:
- Higher expenses of $165 in the third quarter and for the first nine months due to a change in our policy regarding the timing for earning vacation days made in the third quarter of 2006, which reduced expense in 2006.
- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $75 in the third quarter and $351 for the first nine months.
- Contract termination and severance charges of $48 incurred in the third quarter and for the first nine months of 2007.
- Salary and wage merit increases and other bonus accrual adjustments of $19 in the third quarter and $174 for the first nine months.

Offsetting these increases, cost of sales in 2007 decreased due to:
- Lower traffic compensation expenses (for access to another carrier’s network) of $165 in the third quarter and $662 for the first nine months primarily due to migration of long-distance calls onto our network and a lower volume of national mass-market customers.
    - Lower benefit expenses, consisting primarily of our combined net pension and postretirement cost, of $106 in the third quarter and $395 for the first nine months, primarily due to the increase of our discount rate from 5.75% to 6.00% (a decrease to expense) and favorable asset returns resulting in a decrease in the recognition of net losses. Other benefits decreased primarily due to workforce reductions.
- Lower cost of equipment sales and related network integration services of $178 for the first nine months primarily due to less emphasis on sales of lower-margin equipment. Costs associated with equipment for large-business customers (as well as DSL) typically are greater than costs associated with services that are provided over multiple years.
- Lower expenses of $30 in the third quarter and $163 for the first nine months due to the discontinuance of DSL Universal Service Fund fees, which began in the third quarter of 2006.

Selling, general and administrative expenses increased $1,037, or 33.8%, in the third quarter and $2,341, or 23.8%, for the first nine months of 2007, primarily due to the acquisition of BellSouth, which increased expenses approximately $580 in the third quarter and $1,880 for the first nine months of 2007. Selling, general and administrative expenses consist of our provision for uncollectible accounts; advertising costs; sales and marketing functions, including our retail and wholesale customer service centers; centrally-managed real estate costs, including maintenance and utilities on all owned and leased buildings; credit and collection functions; and corporate overhead costs, such as finance, legal, human resources and external affairs. Pension and postretirement costs are also included to the extent that they relate to employees who perform the functions listed in this paragraph.

In addition to the impact of the BellSouth acquisition, selling, general and administrative expenses in 2007 increased due to the following:
- Higher expenses of $185 in the third quarter and for the first nine months related to legal proceedings.

- Higher expenses of $70 in the third quarter and for the first nine months due to a change in our policy regarding the timing for earning vacation days made in the third quarter of 2006, which reduced expense in 2006.
  - Higher provision for uncollectible accounts of $18 in the third quarter and $43 for the first nine months.
- Salary and wage merit increases and other bonus accrual adjustments of $13 in the third quarter and $84 for the first nine months.

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