AT&T INC.
Form 10-Q
August 01, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from to

Commission File Number 1-8610

AT&T INC.

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

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

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

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

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

	[X]	Accelerated filer	[ ]

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

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

At July 31, 2014, there were 5,186 million common shares outstanding.

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Operating Revenues	$32,575	$32,075	$65,051	$63,431
Operating Expenses				
Cost of services and sales (exclusive of depreciation and amortization shown separately below)	14,212	13,270	27,533	25,824
Selling, general and administrative	8,197	8,121	16,457	16,454
Depreciation and amortization	4,550	4,571	9,167	9,100
Total operating expenses	26,959	25,962	53,157	51,378
Operating Income	5,616	6,113	11,894	12,053
Other Income (Expense)				
Interest expense	(881)	(825)	(1,741)	(1,652)
Equity in net income of affiliates	102	218	190	403
Other income (expense) – net	1,269	288	1,414	320
Total other income (expense)	490	(319)	(137)	(929)
Income Before Income Taxes	6,106	5,794	11,757	11,124
Income tax expense	2,485	1,914	4,402	3,471
Net Income	3,621	3,880	7,355	7,653
Less: Net Income Attributable to Noncontrolling Interest	(74)	(58)	(156)	(131)
Net Income Attributable to AT&T	$3,547	$3,822	$7,199	$7,522
Basic Earnings Per Share Attributable to AT&T	$0.68	$0.71	$1.38	$1.38
Diluted Earnings Per Share Attributable to AT&T	$0.68	$0.71	$1.38	$1.38
Weighted Average Number of Common Shares Outstanding – Basic (in millions)	5,204	5,381	5,213	5,446
Weighted Average Number of Common Shares Outstanding – with Dilution (in millions)	5,220	5,397	5,229	5,463
Dividends Declared Per Common Share	$0.46	$0.45	$0.92	$0.90

See Notes to Consolidated Financial Statements.

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

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Net income	$3,621	$3,880	$7,355	$7,653
Other comprehensive income, net of tax:				
Foreign Currency:				
Translation adjustments (includes $1, $(1), $1 and $(1) attributable to noncontrolling interest), net of taxes of $15, $(127), $5 and $(65)	26	(239)	6	(118)
Reclassification adjustment included in net income, net of taxes of $210, $19, $224 and $19	391	34	416	34
Available-for-sale securities:				
Net unrealized gains, net of taxes of $24, $6, $34 and $46	43	11	59	86
Reclassification adjustment realized in net income, net of taxes of $(1), $(1), $(8) and $(5)	(3)	(3)	(14)	(10)
Cash flow hedges:				
Net unrealized gains (losses), net of taxes of $(56), $66, $(53) and $115	(104)	120	(98)	210
Reclassification adjustment included in net income, net of taxes of $7, $4, $11 and $8	14	8	21	15
Defined benefit postretirement plans:				
Reclassification adjustment included in net income, net of taxes $31, $5, $33 and $5	58	8	61	8
Amortization of net prior service credit included in net income, net of taxes of $(142), $(109), $(289) and $(218)	(239)	(177)	(479)	(355)
Other comprehensive income (loss)	186	(238)	(28)	(130)
Total comprehensive income	3,807	3,642	7,327	7,523
Less: Total comprehensive income attributable to noncontrolling interest	(75)	(57)	(157)	(130)
Total Comprehensive Income Attributable to AT&T	$3,732	$3,585	$7,170	$7,393

See Notes to Consolidated Financial Statements.

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

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current Assets		
Cash and cash equivalents	$ 11,305	$ 3,339
Accounts receivable - net of allowances for doubtful accounts of $461 and $483	13,001	12,918
Prepaid expenses	928	960
Deferred income taxes	1,180	1,199
Other current assets	6,698	4,780
Total current assets	33,112	23,196
Property, plant and equipment	283,252	274,798
Less: accumulated depreciation and amortization	(168,892)	(163,830)
Property, Plant and Equipment – Net	114,360	110,968
Goodwill	70,094	69,273
Licenses	59,655	56,433
Other Intangible Assets – Net	6,380	5,779
Investments in Equity Affiliates	159	3,860
Other Assets	9,706	8,278
Total Assets	$ 293,466	$ 277,787
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	$ 10,482	$ 5,498
Accounts payable and accrued liabilities	22,966	21,107
Advanced billing and customer deposits	3,990	4,212
Accrued taxes	3,962	1,774
Dividends payable	2,388	2,404
Total current liabilities	43,788	34,995
Long-Term Debt	73,570	69,290
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	36,835	36,308
Postemployment benefit obligation	30,070	29,946
Other noncurrent liabilities	16,578	15,766
Total deferred credits and other noncurrent liabilities	83,483	82,020
Stockholders' Equity		
Common stock ($1 par value, 14,000,000,000 authorized at June 30, 2014 and December 31, 2013: issued 6,495,231,088 at June 30, 2014 and December 31, 2013)	6,495	6,495
Additional paid-in capital	91,057	91,091
Retained earnings	33,554	31,141
Treasury stock (1,304,409,511 at June 30, 2014 and 1,268,914,913 at December 31, 2013, at cost)	(46,825)	(45,619)
Accumulated other comprehensive income	7,851	7,880
Noncontrolling interest	493	494
Total stockholders' equity	92,625	91,482

Total Liabilities and Stockholders’ Equity	$293,466	$277,787

See Notes to Consolidated Financial Statements.

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

	Six months ended June 30, 2014	2013
Operating Activities		
Net income	$7,355	$7,653
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,167	9,100
Undistributed earnings from investments in equity affiliates	(58)	(198)
Provision for uncollectible accounts	444	439
Deferred income tax expense	546	1,081
Net gain from sale of investments, net of impairments	(1,365)	(260)
Changes in operating assets and liabilities:		
Accounts receivable	(566)	(290)
Other current assets	(771)	784
Accounts payable and accrued liabilities	2,894	(340)
Retirement benefit funding	(280)	-
Other - net	(497)	(258)
Total adjustments	9,514	10,058
Net Cash Provided by Operating Activities	16,869	17,711
Investing Activities		
Construction and capital expenditures:		
Capital expenditures	(11,649)	(9,665)
Interest during construction	(118)	(140)
Acquisitions, net of cash acquired	(857)	(1,182)
Dispositions	4,921	825
Return of advances to and investments in equity affiliates	2	301
Other	-	(4)
Net Cash Used in Investing Activities	(7,701)	(9,865)
Financing Activities		
Net change in short-term borrowings with original maturities of three months or less	134	-
Issuance of other short-term borrowings	-	1,476
Repayment of other short-term borrowings	-	(233)
Issuance of long-term debt	8,564	6,416
Repayment of long-term debt	(3,508)	(1,823)
Purchase of treasury stock	(1,396)	(9,217)
Issuance of treasury stock	27	104
Dividends paid	(4,784)	(4,930)
Other	(239)	41
Net Cash Used in Financing Activities	(1,202)	(8,166)
Net increase (decrease) in cash and cash equivalents	7,966	(320)
Cash and cash equivalents beginning of year	3,339	4,868
Cash and Cash Equivalents End of Period	$11,305	$4,548
Cash paid during the six months ended June 30 for:		

Interest	$2,292	$2,002
Income taxes, net of refunds	$987	$591

See Notes to Consolidated Financial Statements.

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

	June 30, 2014		
	Shares		Amount
Common Stock			
Balance at beginning of year	6,495	$	6,495
Issuance of stock	-		-
Balance at end of period	6,495	$	6,495
Additional Paid-In Capital			
Balance at beginning of year		$	91,091
Issuance of treasury stock			4
Share-based payments			(34)
Change related to acquisition of interests held by noncontrolling owners			(4)
Balance at end of period		$	91,057
Retained Earnings			
Balance at beginning of year		$	31,141
Net income attributable to AT&T ($1.38 per diluted share)			7,199
Dividends to stockholders ($0.92 per share)			(4,786)
Balance at end of period		$	33,554
Treasury Stock			
Balance at beginning of year	(1,269)	$	(45,619)
Repurchase of common stock	(42)		(1,396)
Issuance of treasury stock	7		190
Balance at end of period	(1,304)	$	(46,825)
Accumulated Other Comprehensive Income Attributable to AT&T, net of tax			
Balance at beginning of year		$	7,880
Other comprehensive loss attributable to AT&T			(29)
Balance at end of period		$	7,851
Noncontrolling Interest			
Balance at beginning of year		$	494
Net income attributable to noncontrolling interest			156
Distributions			(158)
Translation adjustments attributable to noncontrolling interest, net of taxes			1
Balance at end of period		$	493
Total Stockholders' Equity at beginning of year		$	91,482
Total Stockholders' Equity at end of period		$	92,625

See Notes to Consolidated Financial Statements.

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AT&T INC.
JUNE 30, 2014

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

NOTE 1. PREPARATION OF INTERIM FINANCIAL STATEMENTS

Basis of Presentation Throughout this document, AT&T Inc. is referred to as "AT&T," "we" or the "Company." We believe that these consolidated financial statements include all adjustments, consisting only of normal recurring accruals, that are necessary to present fairly the results for the presented interim periods. The results for the interim periods are not necessarily indicative of those for the full year. You should read this document in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2013. On March 13, 2014, we closed our acquisition of Leap Wireless International, Inc. (Leap) (see Note 7), and we incorporated Leap into our wireless operations following the date of acquisition.

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 communications services, traditional wireline voice services, data/broadband and Internet services, video services, telecommunications equipment, managed networking and wholesale services.

All significant intercompany transactions are eliminated in the consolidation process. Investments in less than majority-owned subsidiaries and partnerships where we have significant influence are accounted for under the equity method. Earnings from certain foreign equity investments accounted for using the equity method are included for periods ended within up to one month of our period end. We also record our proportionate share of our equity method investees' other comprehensive income (OCI) items, including actuarial gains and losses on pension and other postretirement benefit obligations. On June 30, 2014, we completed the sale of our investment in América Móvil, S.A.B. de C.V. (América Móvil) to an unrelated third party (see Note 7).

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimates of probable losses and expenses. Actual results could differ from those estimates. Certain amounts have been reclassified to conform to the current period's presentation.

Stock Repurchase Program During the first six months of 2014, we repurchased approximately 42 million shares for $1,396 under a repurchase authorization that was approved by our Board of Directors in March 2013. In March 2014, our Board of Directors approved another authorization to repurchase 300 million shares of our common stock. At June 30, 2014, we had 421 million shares remaining under these authorizations. The repurchase authorizations have no expiration date, and we expect to make future repurchases opportunistically.

Software Costs During 2014, we completed a study evaluating the periods that we were utilizing our non-network software assets. As of April 1, 2014, we modified our amortization period for capitalized non-network software to five years to better reflect the estimated periods during which these assets will remain in service and to align with amortization periods used in the industry. Had we not revised the amortization period, our depreciation and amortization expense would have been $4,763 in the second quarter and $9,380 for the first six months.

New Accounting Standards In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" (ASU 2014-09), which replaces existing revenue recognition rules with a comprehensive revenue measurement and recognition standard and expanded disclosure requirements. Upon initial evaluation, we believe the key changes in the standard that impact our revenue recognition relate to the allocation of contract revenues between service and equipment, and the timing in which those revenues are recognized. ASU 2014-09 also specifies that incremental costs of obtaining or fulfilling our contracts with customers should be deferred. ASU 2014-09 becomes effective for annual reporting periods beginning after December 15, 2016.

The FASB will allow two adoption methods under ASU 2014-09. Under one method, a company will apply the rules to contracts in all reporting periods presented, subject to certain allowable exceptions. Under the other method, a company will apply the rules to all contracts existing as of January 1, 2017, recognizing in beginning retained earnings an adjustment for the cumulative effect of the change and provide additional disclosures comparing results to previous rules. We continue to evaluate the impact of the new standard and available adoption methods.

AT&T INC.
JUNE 30, 2014

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

NOTE 2. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings for the three and six months ended June 30, 2014 and 2013, is shown in the table below:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Numerators				
Numerator for basic earnings per share:				
Net Income	$ 3,621	$ 3,880	$ 7,355	$ 7,653
Less: Net income attributable to noncontrolling interest	(74)	(58)	(156)	(131)
Net Income attributable to AT&T	3,547	3,822	7,199	7,522
Dilutive potential common shares:				
Share-based payment	3	2	7	6
Numerator for diluted earnings per share	$ 3,550	$ 3,824	$ 7,206	$ 7,528
Denominators (000,000)				
Denominator for basic earnings per share:				
Weighted average number of common shares outstanding	5,204	5,381	5,213	5,446
Dilutive potential common shares:				
Share-based payment (in shares)	16	16	16	17
Denominator for diluted earnings per share	5,220	5,397	5,229	5,463
Basic earnings per share attributable to AT&T	$ 0.68	$ 0.71	$ 1.38	$ 1.38
Diluted earnings per share attributable to AT&T	$ 0.68	$ 0.71	$ 1.38	$ 1.38

At June 30, 2014 and 2013, we had issued and outstanding options to purchase approximately 11 million and 13 million shares of AT&T common stock. For the quarter ended June 30, 2014 and 2013, the exercise prices of 3 million and 2 million shares were above the market price of AT&T stock for the respective periods. Accordingly, we did not include these amounts in determining the dilutive potential common shares.

AT&T INC.
JUNE 30, 2014

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

NOTE 3. OTHER COMPREHENSIVE INCOME

Changes in the balances of each component included in accumulated other comprehensive income (accumulated OCI) for the six months ended June 30, 2014 and 2013, are presented below. For the period ended June 30, 2014, the amounts reclassified from accumulated OCI include the adjustments resulting from our change in accounting for América Móvil (see Note 7). All amounts are net of tax and exclude noncontrolling interest.

At June 30, 2014 and for the period ended:

	Foreign Currency Translation Adjustment	Net Unrealized Gains (Losses) on Available-for-Sale Securities	Net Unrealized Gains (Losses) on Cash Flow Hedges	Defined Benefit Postretirement Plans	Accumulated Other Comprehensive Income
Balance as of December 31, 2013	$ (367)	$ 450	$ 445	$ 7,352	$ 7,880
Other comprehensive income (loss) before reclassifications	5	59	(98)	-	(34)
Amounts reclassified from accumulated OCI	416 1	(14) 2	21 3	(418) 4	5
Net other comprehensive income (loss)	421	45	(77)	(418)	(29)
Balance as of June 30, 2014	$ 54	$ 495	$ 368	$ 6,934	$ 7,851

At June 30, 2013 and for the period ended:

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

Balance as of December 31, 2012	$ (284)	$ 272	$ (110)	$ 5,358	$ 5,236
Other comprehensive income (loss) before reclassifications	(117)	86	210	-	179
Amounts reclassified from accumulated OCI	34 [1]	(10) [2]	15 [3]	(347) [4]	(308)
Net other comprehensive income (loss)	(83)	76	225	(347)	(129)
Balance as of June 30, 2013	$ (367)	$ 348	$ 115	$ 5,011	$ 5,107

1 Pre-tax translation loss reclassifications are included in Other income (expense) - net in the consolidated statements of income.

2 Pre-tax gains are included in Other income (expense) - net in the consolidated statements of income.

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

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

Actuarial loss reclassifications related to our equity method investees are included in Other income (expense) - net in the consolidated statements of income.

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AT&T INC.
JUNE 30, 2014

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

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services over various technology platforms and are managed accordingly. We analyze our operating segments based on segment income before income taxes. We make our capital allocation decisions based on our strategic direction of the business, needs of the network (wireless or wireline) providing services and demands to provide emerging services to our customers. Actuarial gains and losses from pension and other postretirement benefits, interest expense and other income (expense) – net, are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in each segment’s reportable results. The customers and long-lived assets of our reportable segments are predominantly in the United States. We have two reportable segments: (1) Wireless and (2) Wireline.

The Wireless segment uses our nationwide network to provide consumer and business customers with wireless data and voice communications services. This segment includes our portion of the results from our mobile wallet joint venture which is accounted for as an equity investment.

The Wireline segment uses our regional, national and global network to provide consumer and business customers with data and voice communications services, AT&T U-verse® high speed Internet, video and VoIP services and managed networking to business customers.

The Corporate and Other column includes unallocated corporate expenses, which includes costs to support corporate-driven activities and operations, impacts of corporate-wide decisions for which the individual operating segments are not being evaluated, including interest costs and expected return on plan assets for our pension and postretirement benefit plans as well as our actuarial gains and losses on our pension and postretirement plan valuations. Results from equity method investments in América Móvil (prior to our May 2014 announcement of our intention to dispose of our investment), YP Holdings LLC, and Otter Media (our joint venture with The Chernin Group), are also excluded from our segment results as those results are nonoperational and not considered in our assessment of segment performance. We have revised our prior-period presentation to conform to our current reporting.

AT&T INC.
JUNE 30, 2014

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

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

For the three months ended June 30, 2014

	Wireless	Wireline	Corporate and Other	Consolidated Results
Service	$15,148	$14,408	$-	$ 29,556
Equipment	2,782	229	8	3,019
Total segment operating revenues	17,930	14,637	8	32,575
Operations and support expenses	11,568	10,700	141	22,409
Depreciation and amortization expenses	2,035	2,514	1	4,550
Total segment operating expenses	13,603	13,214	142	26,959
Segment operating income (loss)	4,327	1,423	(134)	5,616
Interest expense	-	-	881	881
Equity in net income (loss) of affiliates	(29)	-	131	102
Other income (expense) – net	-	-	1,269	1,269
Segment income before income taxes	$4,298	$1,423	$385	$ 6,106

For the six months ended June 30, 2014

	Wireless	Wireline	Corporate and Other	Consolidated Results
Service	$30,535	$28,797	$-	$ 59,332
Equipment	5,261	441	17	5,719
Total segment operating revenues	35,796	29,238	17	65,051
Operations and support expenses	22,450	21,157	383	43,990
Depreciation and amortization expenses	3,966	5,198	3	9,167
Total segment operating expenses	26,416	26,355	386	53,157
Segment operating income (loss)	9,380	2,883	(369)	11,894
Interest expense	-	-	1,741	1,741
Equity in net income (loss) of affiliates	(49)	1	238	190
Other income (expense) – net	-	-	1,414	1,414
Segment income (loss) before income taxes	$9,331	$2,884	$(458)	$ 11,757

AT&T INC.
JUNE 30, 2014

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

For the three months ended June 30, 2013

	Wireless	Wireline	Corporate and Other	Consolidated Results
Service	$15,370	$14,482	$-	$ 29,852
Equipment	1,921	291	11	2,223
Total segment operating revenues	17,291	14,773	11	32,075
Operations and support expenses	10,770	10,417	204	21,391
Depreciation and amortization expenses	1,843	2,722	6	4,571
Total segment operating expenses	12,613	13,139	210	25,962
Segment operating income (loss)	4,678	1,634	(199)	6,113
Interest expense	-	-	825	825
Equity in net income (loss) of affiliates	(19)	-	237	218
Other income (expense) – net	-	-	288	288
Segment income (loss) before income taxes	$4,659	$1,634	$(499)	$ 5,794

For the six months ended June 30, 2013

	Wireless	Wireline	Corporate and Other	Consolidated Results
Service	$30,432	$28,863	$-	$ 59,295
Equipment	3,550	565	21	4,136
Total segment operating revenues	33,982	29,428	21	63,431
Operations and support expenses	20,950	20,752	576	42,278
Depreciation and amortization expenses	3,678	5,410	12	9,100
Total segment operating expenses	24,628	26,162	588	51,378
Segment operating income (loss)	9,354	3,266	(567)	12,053
Interest expense	-	-	1,652	1,652
Equity in net income (loss) of affiliates	(37)	1	439	403
Other income (expense) – net	-	-	320	320
Segment income (loss) before income taxes	$9,317	$3,267	$(1,460)	$ 11,124

NOTE 5. PENSION AND POSTRETIREMENT BENEFITS

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

In July 2014, the U.S. Department of Labor (DOL) published in the Federal Register their final retroactive approval of our September 9, 2013 voluntary contribution of a preferred equity interest in AT&T Mobility II LLC, the primary holding company for our wireless business, to the trust used to pay pension benefits under our qualified pension plans. The preferred equity interest had a value of $9,187 at June 30, 2014. The trust is entitled to receive cumulative cash distributions of $560 per annum, which will be distributed quarterly in equal amounts and will be accounted for as contributions. We distributed $280 to the trust during the six months ended June 30, 2014. So long as we make the distributions, the terms of the preferred interest will impose no limitations on our ability to declare a dividend, or repurchase shares. This preferred equity interest is a plan asset under ERISA and is recognized as such in the plan's separate financial statements. However, because the preferred equity interest is not unconditionally transferable to an unrelated party, it is not reflected in plan assets in our consolidated financial statements and instead has been eliminated in consolidation.

AT&T INC.
JUNE 30, 2014

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

We recognize actuarial gains and losses on pension and postretirement plan assets in our operating results at our annual measurement date of December 31, unless earlier remeasurements are required. The following table details pension and postretirement benefit costs included in operating expenses in the accompanying consolidated statements of income, expense credits are denoted with parentheses. A portion of these expenses is capitalized as part of internal construction projects, providing a small reduction in the net expense recorded.

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Pension cost:				
Service cost – benefits earned during the period	$282	$330	$564	$660
Interest cost on projected benefit obligation	662	607	1,323	1,214
Expected return on assets	(851)	(828)	(1,700)	(1,656)
Amortization of prior service credit	(23)	(23)	(47)	(46)
Net pension cost	$70	$86	$140	$172
Postretirement cost:				
Service cost – benefits earned during the period	$58	$96	$116	$191
Interest cost on accumulated postretirement benefit obligation	364	389	729	779
Expected return on assets	(162)	(178)	(326)	(356)
Amortization of prior service credit	(362)	(262)	(724)	(525)
Net postretirement (credit) cost	$(102)	$45	$(205)	$89
Combined net pension and postretirement (credit) cost	$(32)	$131	$(65)	$261

Our combined net pension and postretirement cost decreased $163 in the second quarter and $326 for the first six months of 2014. The decrease reflects higher amortization of prior service credits due to plan changes, including changes to future costs for continued retiree healthcare coverage. The decrease also reflects increasing corporate bond rates, which contributed to lower service cost and higher interest costs.

Due in part to our 2013 enhanced retirement offer and projected distribution levels, we expect that lump sum distributions from the plan during 2014 could exceed service and interest costs, resulting in settlement accounting for a portion of our pension plan. This would result in remeasurement of the plans assets and obligations, with remeasurement for each interim period thereafter.

We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. Net supplemental retirement pension benefits cost, which is not included in the table above, was $29 in the second quarter of 2014, of which $28 was interest cost, and $58 for the first six months, of which $55 was interest cost. In 2013, net supplemental retirement pension benefits cost was $28 in the second quarter, of which $26 was interest cost, and $55 for the first six months, of which $51 was interest cost.

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NOTE 6. FAIR VALUE MEASUREMENTS AND DISCLOSURE

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

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

Level 2 Inputs to the valuation methodology include:

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

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

- Fair value is often based on developed models in which there are few, if any, external observations.

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

The valuation methodologies described above may produce a fair value calculation that may not be indicative of future net realizable value or reflective of future fair values. We believe our valuation methods are appropriate and consistent with other market participants. The use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There have been no changes in the methodologies used since December 31, 2013.

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

	June 30, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	$ 83,548	$91,833	$74,484	$79,309
Commercial paper	150	150	20	20
Bank borrowings	5	5	1	1
Investment securities	2,708	2,708	2,450	2,450

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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Following is the fair value leveling for available-for-sale securities and derivatives as of June 30, 2014 and December 31, 2013:

	June 30, 2014			
	Level 1	Level 2	Level 3	Total
Available-for-Sale Securities				
Domestic equities	$1,113	$-	$-	$1,113
International equities	566	-	-	566
Fixed income bonds	-	949	-	949
Asset Derivatives1				
Interest rate swaps	-	203	-	203
Cross-currency swaps	-	2,011	-	2,011
Liability Derivatives1				
Cross-currency swaps	-	(503)	-	(503)

	December 31, 2013			
	Level 1	Level 2	Level 3	Total
Available-for-Sale Securities				
Domestic equities	$1,049	$-	$-	$1,049
International equities	563	-	-	563
Fixed income bonds	-	759	-	759
Asset Derivatives1				
Interest rate swaps	-	191	-	191
Cross-currency swaps	-	1,951	-	1,951
Liability Derivatives1				
Interest rate swaps	-	(7)	-	(7)
Cross-currency swaps	-	(519)	-	(519)

1 Derivatives designated as hedging instruments are reflected as Other assets, Other noncurrent liabilities and, for a portion of interest rate swaps, Other current assets.

Investment Securities
Our investment securities include equities, fixed income bonds and other securities. A substantial portion of the fair values of our available-for-sale securities was estimated based on quoted market prices. Investments in securities not traded on a national securities exchange are valued using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Realized gains and losses on securities are included in “Other income (expense) – net” in the consolidated statements of income using the specific identification method. Unrealized gains and losses, net of tax, on available-for-sale securities are recorded in accumulated OCI. Unrealized losses that are considered other than temporary are recorded in “Other income (expense) – net” with the corresponding reduction to the carrying basis of the investment. Fixed income investments of $90 have maturities of less than one year, $285 within one to three years, $300 within three to five years, and $274 for five or more years.

Our short-term investments (including money market securities) and customer deposits are recorded at amortized cost, and the respective carrying amounts approximate fair values. Our investment securities are recorded in “Other Assets” on the consolidated balance sheets.

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

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

Fair Value Hedging We designate our fixed-to-floating interest rate swaps as fair value hedges. The purpose of these swaps is to manage interest rate risk by managing our mix of fixed-rate and floating-rate debt. These swaps involve the receipt of fixed-rate amounts for floating interest rate payments over the life of the swaps without exchange of the underlying principal amount. Accrued and realized gains or losses from interest rate swaps impact interest expense in the consolidated statements of income. Unrealized gains on interest rate swaps are recorded at fair market value as assets, and unrealized losses on interest rate swaps are recorded at fair market value as liabilities. Changes in the fair values of the interest rate swaps are exactly offset by changes in the fair value of the underlying debt. Gains or losses realized upon early termination of our fair value hedges are recognized in interest expense. In the six months ended June 30, 2014 and June 30, 2013, no ineffectiveness was measured on interest rate swaps designated as fair value hedges.

Cash Flow Hedging We designate our cross-currency swaps as cash flow hedges. We have entered into multiple cross-currency swaps to hedge our exposure to variability in expected future cash flows that are attributable to foreign currency risk generated from the issuance of our Euro, British pound sterling and Canadian dollar denominated debt. These agreements include initial and final exchanges of principal from fixed foreign denominations to fixed U.S. denominated amounts, to be exchanged at a specified rate, which was determined by the market spot rate upon issuance. They also include an interest rate swap of a fixed foreign-denominated rate to a fixed U.S. denominated interest rate.

Unrealized gains on derivatives designated as cash flow hedges are recorded at fair value as assets, and unrealized losses on derivatives designated as cash flow hedges are recorded at fair value as liabilities, both for the period they are outstanding. For derivative instruments designated as cash flow hedges, the effective portion is reported as a component of accumulated OCI until reclassified into interest expense in the same period the hedged transaction affects earnings. The gain or loss on the ineffective portion is recognized as “Other income (expense) – net” in the consolidated statements of income in each period. We evaluate the effectiveness of our cross-currency swaps each quarter. In the six months ended June 30, 2014 and June 30, 2013, no ineffectiveness was measured on cross-currency swaps designated as cash flow hedges.

Periodically, we enter into and designate interest rate locks to partially hedge the risk of changes in interest payments attributable to increases in the benchmark interest rate during the period leading up to the probable issuance of fixed-rate debt. We designate our interest rate locks as cash flow hedges. Gains and losses when we settle our interest rate locks are amortized into income over the life of the related debt, except where a material amount is deemed to be ineffective, which would be immediately reclassified to “Other income (expense) – net” in the consolidated statements of income. Over the next 12 months, we expect to reclassify $43 from accumulated OCI to interest expense due to the amortization of net losses on historical interest rate locks.

We hedge a portion of the exchange risk involved in anticipation of highly probable foreign currency-denominated transactions. In anticipation of these transactions, we often enter into foreign exchange contracts to provide currency at a fixed rate. Some of these instruments are designated as cash flow hedges while others remain nondesignated, largely based on size and duration. Gains and losses at the time we settle or take delivery on our designated foreign exchange contracts are amortized into income in the same period the hedged transaction affects earnings, except where an amount is deemed to be ineffective, which would be immediately reclassified to “Other income (expense) – net” in the consolidated statements of income. In the six months ended June 30, 2014 and June 30, 2013, no ineffectiveness was measured on foreign exchange contracts designated as cash flow hedges.

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Collateral and Credit-Risk Contingency We have entered into agreements with our derivative counterparties establishing collateral thresholds based on respective credit ratings and netting agreements. At June 30, 2014, we had posted collateral of $3 (a deposit asset) and held collateral of $1,755 (a receipt liability). Under the agreements, if our credit rating had been downgraded one rating level by Moody's Investors Service and Standard & Poor's Rating Services and two rating levels by Fitch Ratings, before the final collateral exchange in June, we would have been required to post additional collateral of $50. At December 31, 2013, we had posted collateral of $8 (a deposit asset) and held collateral of $1,600 (a receipt liability). We do not offset the fair value of collateral, whether the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable), against the fair value of the derivative instruments.

Following is the notional amount of our outstanding derivative positions:

	June 30, 2014	December 31, 2013
Interest rate swaps	$6,350	$4,750
Cross-currency swaps	20,650	17,787
Total	$27,000	$22,537

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

Effect of Derivatives on the Consolidated Statements of Income

	Three months ended		Six months ended	
Fair Value Hedging Relationships	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Interest rate swaps (Interest expense):				
Gain (Loss) on interest rate swaps	$ 22	$ (63)	$ 11	$ (87)
Gain (Loss) on long-term debt	(22)	63	(11)	87

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

	Three months ended		Six months ended	
Cash Flow Hedging Relationships	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Cross-currency swaps:				
Gain (Loss) recognized in accumulated OCI	$(160)	$184	$(149)	$325
Interest rate locks:				
Interest income (expense) reclassified from accumulated OCI into income	(11)	(12)	(22)	(23)

Foreign exchange contracts:				
Gain (Loss) recognized in accumulated OCI	-	2	(2)	-

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) - Continued
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NOTE 7. ACQUISITIONS, DISPOSITIONS AND OTHER ADJUSTMENTS

Acquisitions
Leap On March 13, 2014, we acquired Leap, a provider of prepaid wireless service, for fifteen dollars per outstanding share of Leap's common stock, or $1,248 (excluding Leap's cash on hand), plus one nontransferable contingent value right (CVR) per share. The CVR will entitle each Leap stockholder to a pro rata share of the net proceeds of the future sale of the Chicago 700 MHz A-band Federal Communications Commission (FCC) license held by Leap.

The preliminary values of assets acquired under the terms of the agreement were: $3,000 in licenses, $510 in property, plant and equipment, $520 of customer lists, $340 for trade names and $716 of goodwill. The estimated fair value of debt associated with the acquisition of Leap was $3,889, all of which was redeemed or matured by July 31, 2014.

Pending Acquisition
DIRECTV On May 18, 2014, we announced an agreement to acquire DIRECTV in a stock-and-cash transaction for ninety-five dollars per share of DIRECTV's common stock, or approximately $48,500 at the date of announcement. As of June 30, 2014, DIRECTV had approximately $17,691 in net debt. Each DIRECTV shareholder will receive cash of $28.50 per share and $66.50 per share in our stock. The stock portion will be subject to a collar such that DIRECTV shareholders will receive 1.905 AT&T shares if our stock price is below $34.90 per share at closing and 1.724 AT&T shares if our stock price is above $38.58 at closing. If our stock price is between $34.90 and $38.58 at closing, then DIRECTV shareholders will receive a number of shares between 1.724 and 1.905, equal to $66.50 in value. DIRECTV is a premier pay TV provider in the United States and Latin America, with a high-quality customer base, the best selection of programming, the best technology for delivering and viewing high-quality video on any device and the best customer satisfaction among major U.S. cable and satellite TV providers.

The merger agreement must be adopted by DIRECTV's stockholders and is subject to review by the FCC and the Department of Justice and to other closing conditions. It is also a condition that all necessary consents by certain state public utility commissions and foreign governmental entities have been obtained and are in full force and effect. We have obtained all required state regulatory consents. The transaction is expected to close within 12 months of the announcement. The agreement provides certain mutual termination rights for us and DIRECTV, including the right of either party to terminate the agreement if the merger is not consummated by May 18, 2015, subject to extension in certain cases to a date no later than November 13, 2015. Either party may also terminate the agreement if the DIRECTV stockholders' approval has not been obtained at a duly convened meeting of DIRECTV stockholders or an order permanently restraining, enjoining, or otherwise prohibiting consummation of the merger becomes final and non-appealable. In addition, we may terminate the agreement if the DIRECTV board of directors changes its recommendation of the merger in a manner adverse to AT&T prior to the DIRECTV stockholders' approval having been obtained. The parties also have agreed that in the event that DIRECTV's agreement for the "NFL Sunday Ticket" service is not renewed substantially on the terms discussed between the parties, the Company may elect not to consummate the Merger, but the Company will not have a damages claim arising out of such failure so long as DIRECTV used its reasonable best efforts to obtain such renewal. Under certain circumstances relating to a competing transaction, DIRECTV may be required to pay a termination fee to us in connection with or following a termination of the agreement.

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Disposition
América Móvil In May 2014, in conjunction with the announcement of our intention to dispose of our investment in América Móvil and the resignation of our board members from the board of América Móvil, we discontinued accounting for this investment under the equity method due to our lack of significant influence. On June 30, 2014, we sold our remaining stake in América Móvil for approximately $5,566 and recorded a pre-tax gain of $1,243. At closing, we received $4,565 cash and have agreed to receive a final cash payment of approximately $1,001 within 60 days. To date we have received partial payments totaling $650.

Pending Disposition
Connecticut Wireline In December 2013, we entered into an agreement to sell our incumbent local exchange operations in Connecticut for $2,000 in cash. The transaction was approved by the FCC on July 25, 2014 and is pending before the Connecticut Public Utilities Regulatory Authority and other state regulatory authorities. We expect the deal to close in the fourth quarter of 2014, subject to customary closing conditions.

We applied held-for-sale treatment to the assets and liabilities of the Connecticut operations, and, accordingly, included the assets in “Other current assets,” and the related liabilities in “Accounts payable and accrued liabilities,” on our consolidated balance sheets. However, the business does not qualify as discontinued operations as we expect significant continuing direct cash flows related to the disposed operations. Assets and liabilities of the Connecticut operations included the following:

	June 30, 2014	December 31, 2013
Assets held for sale:		
Current assets	$122	$155
Property, plant and equipment - net	1,388	1,289
Goodwill	799	799
Other assets	18	17
Total assets	$2,327	$2,260
Liabilities related to assets held for sale:		
Current liabilities	$125	$128
Noncurrent liabilities	478	480
Total liabilities	$603	$608

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NOTE 8. SALE OF EQUIPMENT INSTALLMENT RECEIVABLES

We offer our customers the option to purchase certain wireless devices in installments over a period of up to 24 months, with the right to trade in the original equipment for a new device and have the remaining unpaid balance satisfied. As of June 30, 2014, gross equipment installment receivables of $2,427 were included on our consolidated balance sheets.

On June 27, 2014, we entered into uncommitted agreements pertaining to the sale of equipment installment receivables and related security with Citibank, N.A. and various other relationship banks as purchasers (collectively, the Purchasers) with a funding amount not expected to exceed $2,000 at any given time. Under the agreement, we may transfer the receivables to the Purchasers for cash and additional consideration upon settlement of the receivables. Under the terms of the arrangement, we continue to bill and collect on behalf of our customers for the receivables sold.

On June 27, 2014, we sold to the Purchasers equipment installment receivables totaling $1,637 (or $1,391 net of allowance, imputed interest and trade-in right guarantees) and received cash proceeds of $819 and will collect the remaining balance over the remaining term of the equipment installment contracts. We have recorded a deferred purchase price of $565 that assumes customers elect to trade-in their device and agree to a new contract with AT&T; however, if customers choose not to trade-in, we expect to receive the remaining installments. The deferred purchase price was recorded at estimated fair value, which was based on remaining installment payments expected to be collected, adjusted by the expected timing and value of the device trade-ins. The value of the device trade-ins considers estimated prices offered to us by independent, third parties that contemplate changes in value after the launch of a device. Our maximum exposure to loss as a result of selling these is limited to the amount of our deferred purchase price at any point in time.

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

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

For ease of reading, AT&T Inc. is referred to as "we," "AT&T" or the "Company" throughout this document, and the names of the particular subsidiaries and affiliates providing the services generally have been omitted. AT&T is a holding company whose subsidiaries and affiliates operate in the communications services industry both in the United States and internationally, providing wireless and wireline telecommunication services and equipment. 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, 2013. A reference to a "Note" in this section refers to the accompanying Notes to Consolidated Financial Statements. In the tables throughout this section, percentage increases and decreases that are not considered meaningful are denoted with a dash. Certain amounts have been reclassified to conform to the current period's presentation.

Consolidated Results Our financial results in the second quarter and for the first six months of 2014 and 2013 are summarized as follows:

	Second Quarter			Six-Month Period		
	2014	2013	Percent Change	2014	2013	Percent Change
Operating Revenues	$32,575	$32,075	1.6 %	$65,051	$63,431	2.6 %
Operating expenses						
Cost of services and sales	14,212	13,270	7.1	27,533	25,824	6.6
Selling, general and administrative	8,197	8,121	0.9	16,457	16,454	-
Depreciation and amortization	4,550	4,571	(0.5)	9,167	9,100	0.7
Total Operating Expenses	26,959	25,962	3.8	53,157	51,378	