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OVERVIEW:

Co. reported 2Q22 comparative revenues of $29.6b and adjusted EPS from continuing operations of $0.65.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to AT&T's Second Quarter 2022 Earnings Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would like to turn the conference call over to our host, Amir Rozwadowski, Senior Vice President of Finance and Investor Relations. Please go ahead.

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

Thank you, and good morning, everyone. Welcome to our second quarter call. I'm Amir Rozwadowski, Head of Investor Relations for AT&T. Joining me on the call today are John Stankey, our CEO; and Pascal Desroches, our CFO.

Before we begin, I need to call your attention to our safe harbor statement. It says that some of our comments today may be forward-looking. As such, they're subject to risks and uncertainties described in AT&T's SEC filings. Results may differ materially.

I also want to remind you that we are in the quiet period for the FCC Spectrum Auction 108. So unfortunately, we can't answer questions about that today. And as always, additional information and earnings materials are available on the Investor Relations website.

With that, I'll turn the call over to John Stankey. John?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Thanks, Amir. And good morning, everyone. Thank you for joining us today. Last quarter, I shared that AT&T had entered a new era with the right asset base capabilities and financial structure to become America's best broadband provider. I'm happy to share this morning that we're continuing our progress, improving our infrastructure and expanding our customer base across our twin engines of growth, 5G and Fiber.

We saw historic levels of second quarter net additions, thanks to our discipline and consistent go-to-market strategy and solid execution, building fiber and deploying our mid-band 5G spectrum assets. In Mobility, we brought in the most second quarter postpaid phone net adds in more than a decade, just like last quarter, building on our momentum from 2021.

It's noteworthy that we've sustained this momentum in a highly competitive environment. Industry growth in the first half of 2022 has been stronger than the expectations I shared with you late last year. In our view, this strong performance reinforces that our success is not solely promotion-led, but instead reflective of our improved value proposition in the market.

Even though better-than-anticipated customer growth metrics resulted in some higher-than-expected success-based investment, ARPU and profitability in 2Q improved, and we expect that trend line to accelerate in the second half of the year. As Pascal will discuss shortly, we're, in fact, increasing our service revenue growth guidance for 2022.

In Fiber, we continue to invest in building out a premium network, drive a great build velocity and deliver on our stated expectations for accelerated customer growth through improved penetration rates. We're finding success in serving more customers in new and existing markets with what we believe is the best wired Internet offering available.

This is evidenced by our more than 300,000 second quarter AT&T Fiber net adds, marking our 10th straight quarter with more than 200,000 Fiber net adds. The strength and value of the AT&T Fiber experience is enabling us to increase share in our Fiber footprint and convert more IP broadband Internet subscribers to Fiber subscribers.

Ultimately, our Fiber strategy is a sustainable and long-term technology play that will support key macro trends. We expect to see a continuation of favorable ARPU trends as we expand the availability of what we believe is a best-in-class network with a multi-decade lifespan. So I'm very pleased with the strong customer growth we're seeing.

Our success only reinforces the improved value proposition we're providing, and we expect our investment in top-tier technology to translate into strong resiliency for our services for years to come. Over the last 8 quarters, we've achieved an industry-best 6 million postpaid phone net adds while adding nearly 2.3 million AT&T Fiber customers, increasing our Fiber subscriber base by more than 50%.

I'm also very proud with the progress our teams have made in rapidly expanding our 5G and fiber footprints. I'm pleased to say that we've achieved our target of covering 70 million mid-band POPs 2 quarters ahead of our year-end target, and are now on track to approach 100 million mid-band POPs by the end of this year.

And our expanded Consumer Wireline fiber footprint now gives us the ability to serve 18 million customer locations. This is an increase of nearly 2 million from the start of the year. Our teams are running hard to deliver these world-class services to our customers. And we expect our commitment to investing in our core connectivity networks to serve as the foundation for AT&T's growth for decades to come.

Moving to our second major priority. It's more important than ever we'd be effective and efficient across our operations. The dispositions we executed over the last 2 years provide us with operating flexibility to adjust, as needed, what is proving to be an increasingly pressured economic backdrop without requiring us to materially compromise on our investment priorities and financial obligations.

We have strong visibility on achieving more than $4 billion of our $6 billion transformation cost savings run rate target by the end of this year. As we shared before, we've initially reinvested these savings to fuel growth in our core connectivity businesses. However, as we enter the back half of this year, we expect these savings to start to contribute to the bottom line.

As you're likely aware, we're taking proactive measures, such as selective pricing adjustments, to address as much of the very real inflationary pressures that are clearly impacting all parts of our economy. The pricing strategy we implemented is being executed in a proactive and methodical way that enables some of our longest-standing customers the opportunity to take advantage of our most robust offers while also ensuring that we're responding to the real-time cost pressures in our business.

I believe we've navigated this difficult reality effectively and, thus far, are seeing results that are consistent with our expectations, although not sufficient to cover all inflationary impacts. Last quarter, I shared that we're seeing inflationary pressures, and we estimate those to be more than $1 billion above the elevated cost expectations embedded into our outlook.

We're clearly operating in different times, and the macroeconomic backdrop is evolving in a dynamic manner. Still, we're confident in our ability to emerge in this chapter a stronger company, thanks to our position as one of the world's largest-scaled telecom operators, our improved underlying financial flexibility, the cost reduction initiatives we have in place, the essential nature of the services we provide and our pricing actions that help partially offset these impacts.

With that said, the current environment is not easy to predict. We're seeing more pressure on Business Wireline than expected. And on the consumer side of our business, we're seeing an increase in bad debt to slightly higher than pre-pandemic levels as well as extended cash collection cycles.

However, it's important to note that historical patterns in previous economic cycles suggest customers have managed their accounts similar to what we're experiencing today. In fact, we feel even better about the resiliency of our services, given the elevated importance of connectivity in everyone's lives. We view this cycle no differently and still expect customers will pay their bills, albeit a little less timely.

Furthermore, as I mentioned before, we feel better about our underlying financial flexibility that we have in quite a while. This is why we're confident, we can maintain our focus for growth over the long term by investing in the future of connectivity through 5G and fiber. It's our belief that near-term cyclical economic uncertainty does not warrant a retrenchment in the deployment of long-lived assets.

The long-term economic justification for these investments remain sound, and timing of the market development supports our intent to invest through this cycle. Importantly, we maintained our focus on paying down debt, with the $40 billion in proceeds from the completion of the WarnerMedia Discovery transaction in April helping us to significantly reduce our net debt in the quarter.

I'd also like to touch on free cash flow directly. While free cash did come in lower than we expected this quarter, there were several notable factors that drove this. The first is the timing of higher success-based investments on the back of our robust customer growth.

Additionally, we front-end loaded our capital investment plans in order to kick-start our growth initiatives. We expect these plans to seasonally moderate through the course of the year as we achieve our $24 billion in capital investment plan. And I'm pleased we've been able to effectively manage our supply chain and front-end load some of our work this year.

In addition to these investment-driven impacts, we're seeing some longer collection cycles and inflationary costs that we've not been successful in fully offsetting. These cash flow impacts, along with expectations for a more tempered economic climate in the latter half of the year, have led us to adjust our cash flow expectations for the full year, even with our expected material improvements over the next 2 quarters.

The key takeaway is that we understand the emerging economic pressures on our business and feel confident in our ability to manage through them while, at the same time, investing for the long-term benefit of our customers and shareholders. While we're not immune to the pressures impacting the broader economy, the repositioning of our business to focus on core connectivity solutions, the underlying financial flexibility achieved through a significant reduction of our debt and the ability to invest in access technologies built for the long term allows us to opportunistically maneuver through this economic climate.

Finally, I want to take a moment to discuss our Business Wireline unit and our focused efforts to reposition the asset. There is a sizable base of business revenue coming from legacy voice and data services, and this business is increasingly facing secular pressures as customers replace traditional voice services with mobile and other collaboration solutions.

On the data front, VPN and legacy transport services are being impacted by technology transitions to software-based solutions. Today, approximately half of our segment revenue comes from these types of services. Last quarter, we shared that we're experiencing additional government sector pressure related to the reallocation of spending priorities. This pressure, tied to the timing and restructuring of government spending, continued in 2Q.

While we're hopeful that some spending will return and the Enterprise Infrastructure Solutions contract volumes and share gains will offset pricing reductions over time, we consider it prudent to reset expectations. It's worth noting that approximately 20% of the year-over-year Business Wireline revenue declines in the second quarter were due to government spending impacts.

Lastly, we saw inflation and wholesale network access charges we incur to provide services to customers outside of our footprint due to contractual resets. This cost pressure resulted in more than 20% of the segment's year-over-year EBITDA decline. This pressure will be managed through opportunities to operate more efficiently, movement of traffic to alternate providers, symmetrical wholesale pricing adjustments and natural product migration trends.

Looking ahead, these developments only strengthen our resolve in executing our transformation, including actions to accelerate cost take-outs and simplify our product portfolio. We expect these actions to mitigate the year-over-year pressure in this segment's profitability over time. But we now expect Business Wireline EBITDA declines in the low double digits this year, and our expectation for stabilization extends to the back half of 2024.

However, we remain confident in our efforts to reposition the segment. The deployment of Fiber is leading to an acceleration of growth each quarter in our connectivity solutions, which delivered close to 15% growth this quarter.

Our Fiber expansion also provides us with the ability to gain market share in SMB, which is an underpenetrated segment for us. Moreover, we continue to utilize our business relationships to expand opportunities in Mobility. Since last year, we've taken more than 1 full point of share in the business Mobility space.

Our focus on Fiber and 5G continues to gain traction. And we expect to use our strong enterprise and growing SMB relationships to take advantage of opportunities as they expand. We know this transformation won't happen overnight. But similar to our turnarounds in Mobility and Consumer Wireline, we're confident we have the right strategy in place and in our ability to execute it successfully.

I'll now turn it over to Pascal to discuss the details for the quarter. Pascal?

Pascal Desroches - *AT&T Inc. - Senior Executive VP & CFO*

Thank you, John. And good morning, everyone. Let's start by taking a look at our subscriber results for our market focus areas on Slide 5. As John mentioned, our consistent and disciplined go-to-market strategy continues to resonate with customers.

In the quarter, we had a remarkable 813,000 postpaid phone net adds, our best second quarter in more than a decade. Looking at Fiber, we had 316,000 net adds as we delivered upon our expectations to accelerate our subscriber growth. Our Fiber deployment plans remain on track, and we expect to continue our solid momentum with customers.

Now let's move to our second quarter consolidated financial summary on Slide 6. First, it's important to note, with the closing of the WarnerMedia transaction in April, historical financial results have been recast to present WarnerMedia and certain other divested businesses, including Vrio, Xandr and Playdemic, as discontinued operations.

While continuing operations provide a clearer view of our remaining operations, keep in mind that there continues to be some year-over-year comparative challenges as the prior year results also include DIRECTV and certain other dispositions. Therefore, where applicable, I will highlight our financial results on a comparative like-for-like basis in addition to continuing from operations.

Comparative revenues for the quarter were $29.6 billion, up 2.2% or more than $600 million year-over-year. This was largely driven by wireless revenue growth and, to a lesser extent, higher Mexico and Consumer Wireline revenues, partially offset by declines in Business Wireline.

Comparative adjusted EBITDA was up 1.7% year-over-year as growth in Wireless, Mexico and lower corporate costs were partially offset by Business Wireline declines. We continue to expect the year-over-year EBITDA trend line to progressively improve through the year as we begin to lap 3G shutdown costs and step up investments in technology that began in the second half of 2021.

Adjusted EPS from continuing operations for the quarter was $0.65. On a comparative stand-alone AT&T basis, adjusted EPS was $0.64 in the year-ago quarter. Adjustments for the quarter were made to exclude a gain in our benefit plans, noncash restructuring and impairment charges and our proportionate share of DIRECTV intangible amortization.

Cash from operations for our continuing operations came in at $7.7 billion for the quarter. Capital investments of $6.7 billion was up $1.7 billion year-over-year. Free cash flow was $1.4 billion. DIRECTV cash distributions were $800 million in the quarter.

Cash flow for the quarter was affected by several key factors. First, as expected, we had higher front-end loaded capital investments as we ramped our Fiber and 5G mid-band spectrum deployment. As John already noted, we expect lower capital investment levels in the back half of the year, in line with our expectations of $24 billion.

The second is the timing of consumer collections, as it's taking about 2 more days than last year to collect customer receivables. The impact of this is almost $1 billion for the quarter. The last item is some incremental success-based investments, including device payments tied to accelerate subscriber growth.

Now let's take a deeper look at our Communications segment operating results, starting with Mobility on Slide 7. Our Mobility business continues its record-level momentum. Revenues were up 5.2%, with service revenues growing 4.6%, driven by subscriber growth.

Mobility postpaid phone ARPU was $54.81, up $0.81 sequentially or 1.1% year-over-year. This is ahead of our prior expectations for stabilizing in the second half of the year. This improvement is largely a result of more customers trading up to higher-priced unlimited plans and improved roaming trends.

Our June pricing actions were a modest benefit as well. But given the timing of the increases, we would expect our pricing access to be a larger factor in the back half of the year. Given our expectations for ARPU, we now expect service revenue growth of 4.5% to 5% for the year. That is up from our previously stated expectations of 3%-plus.

Mobility EBITDA increased 2.5% year-over-year despite an approximately $100 million impact from lower CAF II government credits and higher FirstNet cost. We also had around $130 million of higher bad debt expense during the quarter.

While bad debt is now slightly higher than pre-pandemic levels, it is being offset by better-than-expected customer revenue growth. We remain confident that Mobility adjusted EBITDA growth accelerates in the second half of the year due to revenue growth and the lapping of 3G shutdown investments that began in the second half of 2021.

Again, our customer growth performance was better than we expected, especially when you consider we became less active in promotional activities compared to others in our industry. So it's clear to us that the strategic change we made to simplify our go-to-market strategy 2 years ago continue to yield great results and that our value proposition is resonating in the marketplace.

Now let's turn to our operating results for Consumer and Business Wireline on Slide 8. Our Fiber growth was solid as we continue to win share where we have fiber. Our total Consumer Wireline revenues were up again this quarter, even with declines from copper-based broadband services.

Broadband revenues grew 5.6% due to Fiber revenue growth and higher broadband ARPU, driven by a customer mix shift to Fiber and recent broadband pricing actions. Our Fiber ARPU was $61.65, up 5.3% year-over-year, with gross addition intake ARPU in the $65 to $70 range.

We expect overall Fiber ARPU to continue to improve as more customers roll off promotional pricing and on to simplified pricing constructs. We accelerated our fiber footprint build and now have the ability to serve 18 million customer locations with great AT&T Fiber experience that consistently receives high Net Promoter Scores.

As you heard at Analyst Day, our plans center on pivoting from a copper-based product to fiber, and we're doing just that. We continue to expect EBITDA growth to accelerate through the remainder of 2022, driven by continued growth in broadband revenues and the lapping of technology investments that began in the second half of 2021.

Looking at Business Wireline, as John stated, revenues and earnings came in lower than we expected. There are 2 main factors that are driving the shortfall to our expectation: the first is lower revenue than anticipated from the government sector; the second is inflationary pressure on wholesale network access costs.

On a combined basis, these 2 factors accounted for about $100 million in EBITDA pressure year-over-year. While the Business Wireline transition and portfolio rationalization creates incremental pressure on near-term revenues, it underscores the importance of transitioning to our owned and operated connectivity services as well as growing 5G and Fiber-integrated solutions.

In fact, our connectivity services revenue growth continues to accelerate as we are up nearly 15% year-over-year. Both areas, Business 5G and Fiber, continue to perform well, with Business Wireline service revenue growth of 7.4% and a sequential increase in our FirstNet wireless base of more than 300,000.

Before we shift to questions, I want to provide you an update on how we are thinking about the rest of the year, given the dynamic macro environment we're operating in. As I mentioned previously, we like the momentum in our Mobility business, both on a service revenue and EBITDA basis.

While we maintain expectations that 2022 industry postpaid phone demand levels are unlikely to replicate 2021, the strength we experienced in the first half of the year, coupled with better ARPU trends, give us confidence in our raised service revenue outlook and expectations for an improved EBITDA trajectory.

On Consumer Wireline, we are largely trending on plan, given mix shift to higher-ARPU Fiber plans, which is driving both revenue and adjusted EBITDA growth. On Business Wireline, you know the near-term challenges we are facing, which reduces our expectations.

We now expect Business Wireline to decline in the low double-digit EBITDA range for the year. Putting this all together, we remain comfortable in our ability to deliver revenue, adjusted EBITDA and EPS within our prior guidance ranges for the year.

Moving to free cash flow. Given the combination of elevated success-based investment, the potential for further extension of payments by our customers, inflation and the more challenging environment facing our Business Wireline unit, we consider it prudent to take a more conservative outlook to free cash flow for the year.

Given these factors, we anticipate pressure of about $2 billion to our free cash flow guidance from our prior $16 billion range for the year. Now before the questions on how we get to the implied $10 billion of free cash flow in the second half of the year when we generated $4 billion in the first half of the year, let me provide you with some specific items to consider.

Our outlook reflects the following expectations: $3 billion-plus lower device payment versus the first half of the year due to timing; nearly $2 billion lower capital investment versus the first half of the year as we reach our $24 billion expectations for the full year. The balance of the improvement relative to the first half of the year is due to wireless customer growth, including our recent pricing increases and lower cash interest expense.

We expect these benefits to be partially offset by reduced distributions from DIRECTV and our expectations for incremental tax payments in the second half of the year. However, we do expect full year tax payments to be lower than we previously anticipated. Additionally, we expect typical free cash flow seasonality, with the fourth quarter higher than the third quarter.

Although we're not providing an updated 2023 outlook, we expect improved cash conversion of EBITDA in 2023. Here's how. Better Mobility cash flow as we get a full year benefit from a larger subscriber base at higher ARPU level. We expect MVNO volumes to ramp and become more material through the course of the year. International roaming trends should improve as well.

We expect broadband revenue growth from the mix shift to higher-priced fiber to continue. On the cost structure, we expect a full year benefit from our cost transformation efforts implemented in 2022 in conjunction with reaching our $6 billion-plus target by the end of 2023.

Additionally, the cost actions we plan to execute in Business Wireline in the second half of the year should produce more than $300 million of savings in 2023 relative to 2022. Also recall that we have no 3G shutdown costs in 2023.

In addition, we expect lower cash interest expense as we get a full year benefit from the debt paydown actions taken in 2022. All these factors should more than offset the expected lower distribution from DIRECTV and an expected year-over-year increase in cash taxes.

In summary, there is no doubt we're operating in a dynamic macro environment, but we feel confident in both the resilient nature of our business and the underlying financial flexibility we gained from recent dispositions. Amir, that's our presentation. We're now ready for the Q&A.

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

Thank you, Pascal. Operator, we're ready to take the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from the line of John Hodulik with UBS.

John Christopher Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst*

(technical difficulty)

Pascal Desroches - *AT&T Inc. - Senior Executive VP & CFO*

John, you're breaking up.

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

John, you're breaking up.

John Christopher Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst*

Okay. Can you hear me now?

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

Yes.

John Christopher Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst*

Okay. Yes, 2 parts. First, on the -- I guess, for Pascal. (technical difficulty)

Amir Rozwadowski - *AT&T Inc. - Senior VP of Finance & IR*

John, sorry, you're breaking up right now. Why don't we go to the next question and reconnect you?

John Christopher Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst*

Okay.

Operator

Our next question will come from Simon Flannery with Morgan Stanley.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

Just coming back to the 2023 free cash flow, can you help us a little bit with the CapEx? Is that still expected to be about $24 billion before dropping off the following year, especially given that you've said you've pulled forward some of the 5G spend?

And I guess, any updated thoughts on what you want to do in terms of fiber? Are you going to continue at this 3.5 million, 4 million homes or locations a year, and you're going to stop at 30 million? What's the latest thought there?

And then you've referenced DIRECTV a couple of times. I just want to make clear, has anything changed at DIRECTV? Or is this just a quarterly kind of cadence of the payments? Or are you still expecting the same distributions that you put out in your guidance for the '22 and '23 as overall?

Pascal Desroches - *AT&T Inc. - Senior Executive VP & CFO*

Sure. Thanks, Simon. Look, the thing is -- I think you have to keep in mind is one of the things that we -- when we did all the dispositions, we wanted -- our plan was to invest significantly this year and next year, both the $24 billion level.

And as you see, so far, the momentum in our business remains really strong. Those investments are providing attractive returns. And everything we see suggests that these were really good decisions. So yes, we are expecting $24 billion next year. We continue to expect to deploy fiber at the pace we've previously guided.

And as it relates to DIRECTV, nothing has changed at all. We expected around $4 billion this year. As you can see from the first couple of quarters, that's more front-end loaded. And as we -- and next year, we expect $3 billion. So nothing has changed in that regard, and we feel really good about how the business is performing.

Simon William Flannery - *Morgan Stanley, Research Division - MD*

Great. And just a quick follow-up. On the price increases, what's your early read of what customers are doing? Are they paying the extra $6 or $12? Are they migrating to unlimited plans? Is that accretive or not? And any surprises on churn?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Everything is tracking as we kind of expected when we laid it out, Simon. As I shared with you, I think when we indicated we were going to do it, what we have is past models from executing these types of things that allow us to go and try to evaluate how customers are going to react and behave when the changes occur.

And in this particular case, we had a great opportunity to ensure that, while we are going through a price increase on a segment of plans, we were able to also provide the option for a customer to think about moving to other plans and ultimately get more value, and I think, in many cases, very attractive characteristics associated with that. And we're seeing customers do both.

In some cases, they're choosing to pay the increase of their existing plan and not move. But as you would expect, there's a degree of inertia in any subscription base. Sometimes it takes a little bit of time for somebody to process what's occurred and react.

And we're also seeing some use this an opportunity to migrate into better plans and trade up and take not only some of that value that we're giving. But as you're seeing, we're starting to drive the improvements in ARPUs that we told you would occur. And certainly, this is a component of that happening.

But I would tell you, it is tracking as we expected. It will be accretive as we expected. And I think everything we've given you for end of year forecast is consistent with what is occurring right now in the market in the early days of the change.

Operator

Our next question will come from Brett Feldman with Goldman Sachs.

Brett Joseph Feldman - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

And just, I guess, sort of a two-part question related to the timing issue that you highlighted with collections. So the first one is, what gives you confidence it really is a timing issue and not really a nonpayment issue? You alluded to some prior experience in different economic cycles. So I was hoping you can maybe just elaborate on that.

And then I'm curious, to what extent this might be shaping the way you think about going to market, particularly in your wireless business? As you move into the back half of the year? You've obviously done very well with a certain offer or a suite of promotions.

Does it make sense to maintain the same promotional stance in a more difficult environment, particularly where there may be some timing issues? It certainly seems like your financial guidance anticipates lower volumes in the back half. But if that's a misunderstanding, any color there would be helpful.

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Brett, first of all, I'd say that our most recent experience in looking at kind of a challenged cycle is probably coming out of the 2008 recession and the dynamic around it. And as I indicated in my earlier remarks, we've evaluated that. We looked at that.

And that was a pretty stressed time, if you recall. And I don't know that I can exactly predict what's going to occur over the next year or so. But my guess is it probably won't be quite as shocking as that cycle is, what's occurred in a worst-case scenario.

And we go back and we look at patterns and behaviors that have occurred in those cycles and evaluated them. And the other great thing we know that today is we have far better data than we've ever had, that's more dynamic in how we do algorithmic scoring and things like that, that allow us to be even more effective in managing customer risk. So I think we feel pretty comfortable that we've got a reasonable record of data that allows us to do some projection on that as we start to see these things move.

And as I said, this typically is not an issue of people not paying, it's an issue of when they pay. And I don't believe there's anything in our credit scoring and how we've looked at our customer base coming in that would cause those trends to be dramatically different than a previous period.

In terms of how we go to market, I think we had a fantastic quarter. And I don't know that I want to go to market any differently than the quarter that we've put on the Board. In fact, looking at many of your commentaries, you've been articulating that others have been much more aggressive in the market and probably leaning in to promotional activity in a heavier way.

And I would say, I would characterize our approach as being much more tempered and consistent with the past. And we have not really responded to that increased promotional activity that we're seeing from others in the market right now. We've kind of been continuing to play our game, and we've put up a record quarter or a second quarter for ourselves in the 10-year period.

And as I've told you before, we like each of these incremental subscribers we're bringing in. We think the economics of them are very strong, albeit there is investment at the front end to bring them on to the network. But I'm not going to shy away from that kind of growth.

I don't know what the overall market is going to do for the next several quarters. I expect it will be, as I said in my comments, a bit more tepid as maybe economic stress comes in. But I've been saying that we expected it to be a little bit slower for the better part of 9 months now, and it hasn't materialized yet.

We'll take the growth if it comes in. I expect it's going to slow a little bit. And I'm going to continue to play our game as long as it's working, and it's working right now.

Pascal Desroches - *AT&T Inc. - Senior Executive VP & CFO*

And Brett, one other point as it relates to the overall credit quality of our customer base. While we did see an uptick in bad debt, overall, it is nothing at all concerning. It's up slightly from pre-pandemic levels. So our call out here was really just to caution investors, given the broader macro trends that are happening. So we're not, in any way, alarmed by this.

Operator

Our next question will come from the line of Phil Cusick with JPMorgan.

Philip A. Cusick - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

A couple of follow-ups and one new one. Can you, John, talk anything about recent customer trends, June and July? You just said a minute ago, you expect things to slow down, but it doesn't sound like you've seen slower customer trends so far. It's a little surprising, given the elevated DSOs.

And it sounds like you guys don't have a lot of confidence in that 2023 free cash flow number. What -- is there just less visibility so you don't want to cut that now? Or are you still reasonably confident in the $20 billion, and you think you can get there? Or we could use a little more?

And then finally, can you just get into the recent launch of plans that don't include HBO? What's the potential cost savings from that shift of customers away? And what's been the reaction?

John T. Stankey *- AT&T Inc. - CEO, President & Director*

Phil, so let me touch on these first, and then Pascal can come in and backfill to the extent he wishes to do so. So customer trends, first of all, I don't want to go down a path on stuff we haven't disclosed. But the first part of July, as you'd expect, tends to be a little bit more suppressed because it's a high holiday and vacation period. And that's what I would call seasonal and cyclical, and we certainly saw a little bit of that occurring. But I've not seen anything in the market right now that suggests we're seeing a move away from what the first half of the year represented.

And I think kind of moving into the second part of your question, I hate to describe it this way, but I think we got a little bit of a tale of 2 cities going on here. And when you see 9% inflation, it tends to hit those in the low end of the market really, really hard. And it's difficult when you walk up to the gas pump and have to fill the car, and you get the electric bill come in and you see the kind of step-ups that people are seeing. And I think there's an adjustment period that goes on.

The flip side is, you've got another segment of the population that banked a lot of money during the pandemic. They weren't traveling. They weren't dining out. They were feeling a little bit more flush, and they're making different decisions. And as you know, our postpaid base is probably skewed a little bit more to the higher socioeconomic dynamics and probably a bit more insulated.

But there is a portion of the base that clearly is starting to adjust to this dynamic that there's higher calls on their cash in any given quarter, and they're having to adjust betting patterns and behaviors and prioritization of how they order bills. And I think we're seeing that there's a little bit of that starting to occur.

As Pascal said, it's not alarming in the way it's happening, but it is moving out collection cycles a bit, as we typically see when this type of stress starts to show up. And that's what the working capital issue is around it.

So I would tell you, I don't see anything in here that would be out of pattern for this occurring. I think you've got 2 different parts of the economy, though, that are working in different ways. And how they develop over the course of the next several quarters is a little bit of a visibility issue, to be candid with you.

And I don't know, if you'd asked me 6 months ago, we would be seeing 9% inflation annualized. I don't think I would have picked it as being that strong, but here we are. And now the question is, how fast do we eradicate it and what rate? And if you have a good pick on that or good insights, then I can probably be a little bit more precise than what I think '23 brings.

I think what's important to understand is -- Pascal articulated in his comments is the fundamentals of the business are really strong. We feel really good about some of the mechanical things that will improve cash flow yields into '23. That's not going to change.

But what happens in the overall economic pattern is a bit uncertain. And without seeing how the Fed reacts, how fast we see the curve starting to abate on the inflation side, trying to make that pick right now just feels like it's a bit of an overreach. And so I think we're reserving the right to get a little bit more visibility on '23 to declare.

But I think the strong improvement dynamics are what I would call mechanical. And the performance of the business is supporting the fact that we're going to see that improved conversion on cash flow as we move through the year.

And then finally, on your question about the plans is, look, we still have a lot of streaming services in our base that we're using. We're trying a couple of different things. Part of this has been segment driven to look at opportunities for us to address areas that we think there is potential for stronger growth. And we shifted the mix of our plan and what we gave away, so to speak, in some of the benefits, especially as we were executing the price changes that we have talked about previously.

And we felt that, this quarter, and where we stood, that working on things like more generous hotspot capabilities and better roaming moving into the summer might be a better play in the market. And I would tell you, we kind of like what we saw in our results despite a lot of the changes by others in the industry in terms of what their value proposition is to customers.

And it feels like it was a good pivot and rotation at this moment for what we needed to do with the kind of changes we were making broadly in our plans. That doesn't mean that, that's the strategy forever. And it doesn't mean it's the strategy for the rest of the year.

As we move through the summer months and we get through the peak travel periods and we look at what other options we have, we could choose to do something different in what we decide to do from a promotional perspective and what we choose to bring in as part of the bundles moving forward. I don't think anything should be viewed as static.

And I think entertainment, as part of a wireless bundle, is probably something that's going to be around with us in this industry for a good period of time because I think customers -- certain customers resonate with it. And HBO Max is a great product. We like the fact that we're kind of viewed as being the place to come to get it. And when it's right for us to put that up in the front line to do that, we'll continue to do that.

Operator

Our next question comes from the line of Michael Rollins with Citi.

Michael Ian Rollins - *Citigroup Inc., Research Division - MD & U.S. Telecoms Analyst*

So a follow-up and a question. When you're discussing some of the impact that your customers are experiencing this inflationary environment, can you talk about how AT&T is using the ACP program, the size of it, and the opportunity to use that, which may be different than some past cycles customers had deal with potentially tougher macro climate?

And then secondly, just in terms of the infrastructure money that's out there, can you give us an update on your expectations for the size of the opportunity that AT&T could pursue?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Sure, Michael. First of all, I think the most significant change in the ACP program is the fact that we have put out a new product, Access by AT&T (sic) [Access from AT&T]. It's very easy for you to look at that product. All you need to do is search on the Internet, Access by AT&T, and you'll be taken directly to the page that talks about what this is. And it's, of course, tied to ACP dollars.

And that program, I think, is a great program. I think it's good for the consumer. As you know, it offers 100 by $20 -- $30 fixed connection. And we also have options that are available in the wireless space around it as well. And we've been able to, in most of our channels, activate eligibility requirements for ACP. And we're working on ensuring that, that's done.

The government still continues to move around a little bit on some of the qualification criteria and those types of things, and we have to adjust our operations. But I would say, by and large, in most of our mainline channels, we have the ability to qualify customers and to move them into products and service as a result of it. And I think this is a -- it's a healthy program to get those that maybe are a little bit more income challenged to get them into not only new products but better products.

And so I think that's a good thing. I think we still have an issue from a policy perspective in this country on how we sustain this for the long haul. And universal service reform is going to need to be a key element of that as we get out several years from now and the original ACP funding starts to have to be renewed, and we have to look at it differently. But right now, I'd say the program is healthy. I think we're in as good a position as anybody in the market as to what we're doing.

And it's needs-based. But we make it very easy for those needs-based customers to self-identify and qualify at the point of sale and then take advantage of it and move into a product or service. And we think that will be actually, over the long haul, something that makes for more continuity in our relationships with customers as it insulates them a little bit from economic cycles and some of the things that are going on, like higher inflation.

On the infrastructure side, look, I'm optimistic. We haven't given any guidance on what we think that number will be. And I will tell you, frankly, timing-wise, this is a little bit out in the future right now. As you know, the maps are not going to be issued from the FCC until a little bit later this year. And until that happens, the money really can't start to flow at the state level. So we got to get the maps in place.

We've got the procedural process being defined as to how the states will come back to the federal government and seeking the distribution of these funds. They will have to go through there. The state will have to go through their processes to do that. I expect that, that will start to occur into next year. Awards will probably start to materialize, maybe in some meaningful levels, in the middle part, latter part of next year. And then you have to go and build and ultimately bring these things online.

So you're not looking at these things creating what I would call material impact on the '22, '23 plans right now as it moves through the cycle. How much, we'll get a better idea once the rules are set. And each state is going to have authorship over their strategies and approaches. I've shared before that we're actively working with states trying to shape them in ways that we think are meaningful for our business and are good policy for each of the states.

I would point out, there is no company that's building a 2 million connected locations of fiber in 6 months like we are. We are scaling in a way that nobody else is. We are deploying wireless infrastructure at a torrid pace. I think that makes us a good partner. I think at the end of the day, states do care about somebody who's reputable, that can execute, that has a mature supply chain, and a scaled engine to go after should make us very competitive for this money.

And we intend to, through a combination of what we're doing with ACP and our operational prowess and our scale that we're demonstrating and the fact that we've got a product in the market that customers love. It's got the highest NPS out there. I think we should be a very qualified partner to work with government on that, and I'm optimistic that we can avail ourselves with some of that money.

Operator

That question will come from David Barden with Bank of America.

David William Barden - *BofA Securities, Research Division - MD*

I guess I wanted to talk about the second half free cash flow guidance, if you will, for $10 billion and the jumping-off point for 2023. I think, Pascal, you said the biggest moving part is going to be $3 billion less spend on equipment in the second half, which is -- which would not be normal, I think, just because it's a higher upgrade period. You've got the iPhone refresh. I was wondering if you could kind of explain why that's going to be such a big tailwind.

I think the second question would be $2 billion less in CapEx in the second half. We've been expecting AT&T to kind of come with the C-band development and the Auction 110 Spectrum in kind of one big push. And so why is it that the CapEx is coming down even as that begins?

And if I could, one last one is, obviously, the cash flow seems very sensitive to this 1 or 2 days lengthening billing cycle. Are we convinced that the billing cycle has lengthened? Or should we be concerned that it's lengthening as we look into the back part of the year?

Pascal Desroches - *AT&T Inc. - Senior Executive VP & CFO*

Okay. Let me try hitting all of those, and obviously, John can chime in. First, look, the thing to keep in mind is the second -- we pay devices, for example, probably a quarter to 1.5 quarter after the sale has happened. So for Q2, as an example, we're paying for the last part of Q4 and Q1.

So in Q -- for the back half of the year, it's going to be largely activity from the back half of Q2 and Q3. So the holiday sales and the upgrade season, we're going to pay for that in the first half of 2023. And so mechanically, we have really good visibility in terms of the payments that we are likely going to make in the back half of the year.

But overall, given the strong growth we had in the first half of the year, our overall device payments for the year are higher than we anticipated, which, candidly, this is a very good -- it's a very good situation because we think this is attractive growth, and we feel really good about it.

As it relates to CapEx, our fiber build was front-end loaded for the year. Remember, last year, we had some supply chain disruptions, and it took us a while to ramp. We got good exit velocity and exiting 2021, and that continued. And in the first half of the year, we delivered 2 million locations passed. So we feel really good about that.

In terms of our C-band deployment and the pace of that, nothing has changed. We said we were guiding to $24 billion of capital. That remains the case. So we're not spending any more capital than we thought for the year. And remind me the last part of your question?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Days sales outstanding movement.

Pascal Desroches - *AT&T Inc. - Senior Executive VP & CFO*

Oh, days sales outstanding movement. So in terms of DSOs, here's what we know. This is a trend that is relatively nascent. It is probably 6 weeks or so that we start to see an uptick in days sales outstanding. Is it a trend? Is it going to get worse? We don't know. But here's what we do know.

We do know that, as John alluded to, in prior recessions, customers may have paid late, but they paid us. So there's nothing to suggest, given the mission-critical nature of our services, that customers won't pay us because they're going to want to maintain connectivity. So in that regard, we think it is a timing issue.

And I think, in this macro environment, I'm not going to call whether it's going to get much, much worse than where we are today. But we're taking a prudent view and not assuming it's going to get better, given all the uncertainty.

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Dave, the only other thing I would add to what Pascal said is, as you -- we obviously hit our 70 million POP coverage commitment that we made to you that was part of the capital plan for this year 6 months early. And as we told you, we'll be around that 100 million neighborhood as we get to the end of this year. I think it's probably intuitive to you.

But just to remind you, the first 100 million POPs in wireless coverage are very different than the next 100 million POPs, just in terms of kind of capital intensity and what has to be done to make them happen on the number of physical sites you have to touch.

So if you want to think about this, it would not be right to kind of straight-line level of activity and investment as you make your journey to covering most of the United States. And that will probably help you understand maybe some of the rate and pace of things as we move through the year.

Operator

That question will come from the line of Frank Louthan with Raymond James.

Frank Garrett Louthan - *Raymond James & Associates, Inc., Research Division - MD of Equity Research*

Can you comment a little bit on your dividend policy going forward? Is it a priority to grow the dividend by various amounts? That would be great.

And then on part of the business side, I think you commented earlier this year about exiting some lines of business that were really low to no margin. How is that going? And to what extent is that impacting the declines that we're seeing in the business line?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Frank, look, we've been pretty clear on the dividend policy as to what we're doing. And the Board ultimately makes this call and this decision. And as I've said before, we set this at what we think is an incredibly attractive return in the market right now. And I think we are still standing there relative to the yields on the stock.

As I said, the Board will evaluate dividends, along with other choices in front of us to return to shareholders. As we've indicated, our priority right now is to get the balance sheet where we want it, which is a full rush and push to getting to 2.5x, and then we can evaluate what other options are at that point in time.

And those other options will range from whether or not we want to do something on dividend policy or something we want to invest more back into the business or whether we want to push on some buybacks. And those decisions will be weighted at the time when we have those options in front of us and evaluate the market as to where it stands.

Our intent is to ensure that we're returning a good and competitive dividend out to our shareholders, which we have today. And we'll continue to be mindful of that as we go forward, and we see the stock price adjust in what occurs in the value of the business.

On the ABS side, look, I think as you've heard, the repositioning of the asset is -- it's a multi-quarter. This set of processes and approach are backing away from lower-margin products is relatively straightforward. I say relatively because we can make the decision to do it at the front end.

Obviously, in this customer base, we have contracts that sometimes extend for multiple years in a period of time, where we then have to kind of go through a wind-down and wrap-up cycle once we stop selling something. And we're in the middle of that occurring. But the process of choosing not to drive new sales at the front end has been a relatively straightforward set of decisions, and I feel like we're executing reasonably well around that piece of it.

We have dropped the number of products we have in the market pretty demonstrably over the last 1.5 years, and we'll continue down that path. And I think it's that reduction in complexity that will allow us to then scale up what's essential to have a viable franchise moving forward in a robust and growing franchise moving forward, which is one centered on moving product that is on our owned and operated infrastructure.

And what's right about our segment here that I want to stress that we report a little bit differently than some of our peers, we do not report a consolidated business entity in both wireless and wireline services. You should understand, a lot of our strength in the wireless business is coming from our success in our Enterprise business. It's coming from increases in the public sector, in our success of what we've done with FirstNet. It's coming from our success in penetrating deeper into our Enterprise accounts with wireless services.

We're really pleased with the share gains that we've seen in Enterprise moving forward, where we believe we have the opportunities in the mid-market and the low end of the market. And the attractive part about that is it's a twofer. It's not only getting more transport on the fiber infrastructure we're deploying, but we are underpenetrated in the wireless space as we move into those accounts.

So when we deploy fiber and we have an opportunity to talk to mid-market customers about putting more of their transport on AT&T, we also oftentimes get the opportunity to talk to them about moving their wireless account as well. And that's an attractive opportunity for us. It requires us to tune our distribution differently. That's a slow -- a slower process. And we've been making progress around it.

You heard Pascal talk about the growth that we're seeing in our Fiber products. We're seeing some progress in the wireless space in the mid-market, but we're not up to where we need to be yet. We will get there. We play very well in that space. Our brand plays very well in that space. We know how to sell product in that space.

But it's getting the engine kind of hitting all 8 cylinders. It's going to take us a couple more quarters than what we expected. But I'm optimistic we can get there. It's the right asset base. It's the right brand. We know how to approach these customers. And we will make that happen.

Operator

That question will come from the line of Tim Horan with Oppenheimer.

Timothy Kelly Horan - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Two questions. Could you just elaborate a little bit more on the wireline side of the business market? What are you replacing your legacy virtual private line networks with? The same thing with voice. Are you -- I guess, are you retaining these customers? Do you have a product for them? Is it just a lower ARPU issue?

And then secondly, on the CapEx. We're hearing CapEx equipment costs, labor costs are up 10%, 15%. I know you gave your guidance out quite a while ago for next year. I guess, how are you offsetting those price increases that we're hearing about out there, keeping your CapEx flat?

John T. Stankey - *AT&T Inc. - CEO, President & Director*

Tim, so look, the move, as I just articulated, is we want people on owned and operated infrastructure. And so it is -- as people migrate away from VPN and we have a more dense fiber bases, we're selling more fundamental underlying transport, frankly, at higher speeds, and therefore, higher connection values in that segment of the market. And that's where our future is.

We work with layering that on an SDN capability that aggregates that. And that is the replacement product for VPN. And we do very well in the market on that, although there is, typically, in a network replacement, at the top end of the market, some trade-down in total value when that occurs.

That's why this move into the mid-market is so important to us, where we are typically underpenetrated. Because offsetting that trade-down in the enterprise -- top end of the enterprise space, where we are a sheer leader on VPN and have these complex networks, as we have some of that trade-down and the migration on the technology side, market replacement in the mid-market is, is what offsets that and allows us to move the sector back to growth over time as we make that happen.

And again, it's why this investment in fiber in our core business is so critical and important in repositioning our distribution to make that happen. The world, for us, moving forward is a data VPN-replacement world. And that's where we're going to make our bread and butter. Our play in voice is to penetrate more deeply into wireless in these spaces.

Generally speaking, when you look at what's happened on collaboration services, it's moved to other providers that are doing that kind of work. We want the underlying data infrastructure for those collaboration services to run on. And we want to sell more scaled wireless solutions on top of our transport services into these customers to extend our relationship with them. And I think, as I said just a moment to Frank's question, we're doing that fairly effectively. And that's what the future is and how we move forward on it.

On the cost side, we're certainly seeing some pressures as we move through. We've articulated that. We're able to navigate it better than a lot. As we've shared with you previously, we have a lot of long-term contracts in place. I think those help us a lot. I won't tell you they entirely insulate us.

We want our suppliers to be healthy. We pay attention to that. We have good, long-standing partnerships with our suppliers. And I will be candid, we have sat down with them. In some cases, even though not had to pay people more, I've elected to pay people more because I think that makes for a healthier win-win relationship on things moving forward. And we are having to take some costs into our build and what we're doing.

However, these are long-lived assets. And some increase in our build costs, for example, on putting fiber out there is not the end of the world for us. We've shared with you a lot of data on the effectiveness of our build. We've shared with you that when we did the original business case on these things, we're penetrating a lot more rapidly than we thought we would. That has a big impact on the overall return characteristics of this investment. That can overcome maybe some of those per-living unit cost increases.

We really like the ARPU trends we're seeing. We really like the churn trends we're seeing. All those things still make this a really smart and important investment for our business. And I think it's a balancing act as we move through it.

And as we've said before, when you get the asset in the ground and ultimately work through multiple quarters of inflation, building it today is better than building it a year from today. And if it's a long-lived asset and it's an important product, ultimately, we'll probably see some accretion move into ARPUs over time. So I feel like we can manage through this reasonably well, given our scale, given our long-term relationships with folks and the importance and durability of the product over time.

So folks, I really appreciate you taking the time to be with us this morning. And I know you got, from maybe, hopefully, the last time, a little extra work to do this quarter as we work through the disaggregation of discontinued operations and the like in results. And I'm excited about finishing this in this quarter and now moving forward in a more consistent fashion.

We made some hard moves that brought us to this moment that I'll acknowledge. But those hard moves were to, number one, give us the ability and the flexibility to invest heavily in this business and to make sure that we could respond to what goes on in the environment economically, whether economic stress, rising interest rates, et cetera.

And I would say, I'm really pleased we're in this position for having made those decisions. And it's allowed us to do exactly what we intended to do, which is to think about how do we create a durable AT&T with a consistent machine that can deliver the right kind of subscription services for broadband moving forward.

And I think we are doing that. We're building a world-class infrastructure where we're doing that. You're seeing the momentum in the market that we're able to achieve. I view these customer relationships as durable customer relationships that are highly accretive and attractive.

And I will tell you that, as I work with the team, 90 days in this business, with the way we operate and the infrastructure we build, is sometimes a bit like trying to land a plane on the top of a pin. And so when I think about the reality of what we're doing here, we want to look at it over the course of the year. And as the business has the right kind of momentum and I've got people doing their work, we continue to invest. We make sure we put the right things out there.

And a 90-day cycle is not the end of the world in any way, shape or form. Hopefully, we've given you the confidence that we understand what's going to occur in the balance of this year and that we're investing in a way that's going to return for shareholders in a fashion that, I think, we'll all be proud of moving forward.

So thank you very much. I hope you all enjoy the rest of your summer, and we'll talk with you in 90 days.

Operator

Ladies and gentlemen, that does conclude our conference for today. We thank you for your participation and for using AT&T conferencing service. You may now disconnect.
