Dollars in millions except per share amounts

interest in AT&T Mobility under the equity method since we shared control equally with BellSouth. AT&T Mobility is now a wholly-owned subsidiary of AT&T, and wireless results are reflected in operating revenues and expenses in our consolidated statements of income.

Equity in net income of affiliates decreased $1,351 in 2007. The decrease in 2007 was a result of the change in accounting for AT&T Mobility to a wholly-owned subsidiary, partially offset by improved results from our investments in América Móvil S.A. de C.V. (América Móvil) and Teléfonos de México, S.A. de C.V. (Telmex). Equity in net income of affiliates increased $1,434 in 2006. The increase in 2006 was primarily due to AT&T Mobility's improved results, of which $1,308 was our proportionate share.

Other income (expense) – net We had other income of $615 in 2007, $393 in 2006 and $397 in 2005. Results for 2007 included gains of $409 related to a wireless spectrum license exchange, $166 in interest income, $148 from the sale of administrative buildings and other non-strategic assets and $88 from other non-operating activities. These gains were partially offset by $196 in minority interest expense.

Other income for 2006 included interest income of $377. There were no individually significant other income or expense transactions during 2006. Results for 2005 primarily included interest income of $383, a gain of $108 on the sales of shares of Amdocs Limited, American Tower Corp. (American Tower) and Yahoo! Inc. and other miscellaneous gains. These gains were partially offset by other 2005 expenses of $126 to reflect an increase in value of a third-party minority holder's interest in an AT&T subsidiary's preferred stock and other miscellaneous expenses.

Income taxes increased $2,728, or 77.4%, in 2007 and $2,593 in 2006. The increase in income taxes in 2007 was primarily due to higher operating income in 2007 reflecting the addition of BellSouth's and its share of AT&T Mobility's operating results. Our effective tax rate in 2007 was 34.4%, compared to 32.4% in 2006 and 16.3% in 2005. The increase in our effective tax rate for 2007 was primarily due to the consolidation of AT&T Mobility and an increase in income before income taxes. Prior to the consolidation of AT&T Mobility, our income before income taxes included our equity in AT&T Mobility's after-tax net income. With consolidation, the AT&T Mobility income tax expense that was previously netted in income before income taxes is now included in our consolidated income tax expense.

The increase in income tax expense in 2006 compared to 2005 was primarily due to the higher income before income taxes in 2006 and our agreement in December 2005 with the Internal Revenue Service (IRS) to settle certain claims principally related to the utilization of capital losses and tax credits for tax years 1997 – 1999. The settlement reduced income tax expense by $902 in 2005, which also lowered our effective tax rate for 2005. (See Note 10)

Supplemental Information

To provide improved comparability versus previous results, below is a supplemental table providing pro forma consolidated operating revenues for 2005 and 2006, assuming the closing date for the BellSouth and ATTC acquisitions was January 1, 2005.

Supplemental Consolidated Operating Revenues Information

				Percent Change	
	Actual 2007	Pro Forma 2006	Pro Forma 2005	**2007 vs. 2006**	2006 vs. 2005
Segment operating revenues					
Voice	**$ 40,798**	$ 43,505	$ 46,849	**(6.2)%**	(7.1)%
Data	**23,206**	22,173	21,326	**4.7**	4.0
Wireless service	**38,568**	33,692	30,673	**14.5**	9.8
Directory	**4,806**	5,823	5,689	**(17.5)**	2.4
Other	**11,550**	11,861	12,268	**(2.6)**	(3.3)
Total Operating Revenues	**$118,928**	$117,054	$116,805	**1.6%**	0.2%

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

Pro forma data growth was led by an increase in Internet Protocol (IP) data revenues of 13.3% in 2007 and 14.1% in 2006, with strength in high-speed Internet, managed Internet, Virtual Private Network (VPN) and hosting services. Data transport service revenues were up 0.7% in 2007 and 3.3% in 2006, and packet-switched data revenues, which include frame relay and asynchronous transfer mode (ATM) services, were down 7.0% and 12.5%, respectively, consistent with the industry trend of customers switching to IP-based services from traditional circuit-based services.

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

Directory results were lower in 2007 due to the purchase accounting treatment of directories delivered by BellSouth's advertising and publishing businesses in the 12 months prior to the merger (see Note 4). In accordance with GAAP, the deferred revenues from these books were not included in the opening balance sheet and are therefore not included in the 2007 consolidated directory revenues. Had those deferred revenues been included in 2007, directory revenues would have increased by $964. The pro forma revenues for 2005 and 2006 do not reflect this purchase accounting treatment of deferred directory revenues.

Pro forma other revenues decreased in 2007 and 2006 due to our decision to de-emphasize sales of lower-margin, stand-alone customer premises equipment.

Segment Results

Our segments are strategic business units that offer different products and services and are managed accordingly. As a result of our acquisitions of BellSouth and ATTC, we revised our segment reporting to represent how we now manage our business, restating prior periods to conform to the current segments. Our operating segment results presented in Note 4 and discussed below for each segment follow our internal management reporting. We analyze our various operating segments based on segment income before income taxes (see Note 4). Each segment's percentage of total segment operating revenue and income calculations is derived from our segment results table in Note 4 and reflects amounts before eliminations. We have four reportable segments: (1) wireless, (2) wireline, (3) advertising & publishing and (4) other.

The ***wireless segment*** accounted for approximately 35% of our 2007 total segment operating revenues as compared to 37% in 2006 and 32% of our 2007 total segment income as compared to 27% in 2006. This segment offers wireless voice and data communications services across the United States, providing cellular and PCS services. This segment reflects 100% of the results reported by AT&T Mobility, which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. Prior to the acquisition, although we analyzed AT&T Mobility's revenues and expenses under the wireless segment, we eliminated the wireless segment in our consolidated financial statements. In our 2006 and prior consolidated financial statements we reported our 60% proportionate share of AT&T Mobility's results as equity in net income of affiliates.

The ***wireline segment*** accounted for approximately 59% of our 2007 total segment operating revenues as compared to 57% in 2006 and 55% of our 2007 total segment income as compared to 47% in 2006. This segment provides both retail and wholesale landline communications services, including local and long-distance voice, switched access, IP and Internet access data, messaging services, managed networking to business customers, AT&T U-verse℠ TV service (U-verse) and satellite television services through our agency agreements with EchoStar Communications Corp. (EchoStar) and the DIRECTV Group, Inc. (DIRECTV). With the BellSouth acquisition, we now provide local service in 22 states ("in-region").

The ***advertising & publishing segment*** accounted for approximately 5% of our 2007 total segment operating revenues as compared to 4% in 2006 and 9% of our 2007 total segment income as compared to 12% in 2006. This segment includes our directory operations, which publish Yellow and White Pages directories and sell directory and Internet-based advertising. This segment also includes the results of our Internet-based advertising business, YELLOWPAGES.COM (YPC), which was a joint venture with BellSouth prior to the December 29, 2006 acquisition and is now a wholly-owned subsidiary of AT&T. For segment reporting disclosure, we have carried forward the deferred revenue and deferred cost balances for BellSouth at the acquisition date in order to reflect how the segment is managed. This is different from consolidated reporting purposes as under Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141), BellSouth deferred revenue and expenses from directories published during the 12-month period ending with the December 29, 2006 acquisition date are not recognized and therefore were not included in the opening balance sheet. For management reporting purposes, we continue to amortize these balances over the life of the directory (typically 12 months). Thus, our advertising & publishing segment results for 2007 include revenues of $964 and expenses of $308, related to directories published in the Southeast region during 2006, prior to our acquisition of BellSouth. These amounts are eliminated in our consolidated results (see Note 4).

The ***other segment*** accounted for approximately 1% of our 2007 total segment operating revenues as compared to 2% in 2006 and 4% of our 2007 total segment income as compared to 14% in 2006. This segment includes results from Sterling Commerce, Inc. (Sterling), customer information services, payphone, and all corporate and other operations. Additionally, this segment includes our portion of the results from our international equity investments. Prior to December 29, 2006, this segment also included our results from AT&T Mobility as equity in net income of affiliates, as discussed above.

The following tables show components of results of operations by segment. We discuss significant segment results following each table. We discuss capital expenditures for each segment in "Liquidity and Capital Resources."

Dollars in millions except per share amounts

Wireless
Segment Results

				Percent Change	
	2007	2006	2005	**2007 vs. 2006**	2006 vs. 2005
Segment operating revenues					
Service	**$38,678**	$33,788	$30,673	**14.5%**	10.2%
Equipment	**4,006**	3,749	3,795	**6.9**	(1.2)
Total Segment Operating Revenues	**42,684**	37,537	34,468	**13.7**	8.9
Segment operating expenses					
Cost of services and equipment sales	**15,991**	15,057	14,388	**6.2**	4.6
Selling, general and administrative	**12,594**	11,446	11,645	**10.0**	(1.7)
Depreciation and amortization	**7,079**	6,462	6,608	**9.5**	(2.2)
Total Segment Operating Expenses	**35,664**	32,965	32,641	**8.2**	1.0
Segment Operating Income	**7,020**	4,572	1,827	**53.5**	—
Equity in Net Income (Loss) of Affiliates	**16**	40	(11)	**(60.0)**	—
Minority Interest[1]	**(198)**	(169)	(103)	**(17.2)**	(64.1)
Segment Income	**$ 6,838**	$ 4,443	$ 1,713	**53.9%**	—

[1]Minority interest is recorded as "Other Income (Expense) – Net" in the consolidated statements of income.

Accounting for AT&T Mobility
The wireless segment reflects 100% of the results reported by AT&T Mobility (formerly Cingular), which was our wireless joint venture with BellSouth prior to the December 29, 2006 acquisition, at which time it became a wholly-owned subsidiary of AT&T. Prior to the BellSouth acquisition (see Note 2), we accounted for our 60% economic interest in AT&T Mobility under the equity method since we shared control equally with BellSouth. This means that our consolidated results in 2006 and 2005 included our 60% share of AT&T Mobility's results in "Equity in net income of affiliates" in our consolidated statements of income. Following the BellSouth acquisition, AT&T Mobility became a wholly-owned subsidiary and AT&T Mobility's results are included as operating revenues and expenses in our consolidated statements of income. Accordingly, results from this segment for the last two days of 2006 were included in our operating revenues and expenses and not in the "Equity in net income (loss) of affiliates" line. However, for all the periods presented, the wireless segment reflects 100% of the results reported by AT&T Mobility based on the management of the business.

Dobson Acquisition
In November 2007, we acquired Dobson Communications Corporation (Dobson). Dobson marketed wireless services under the Cellular One brand and had provided roaming services to AT&T subsidiaries since 1990. Dobson had 1.7 million subscribers across 17 states, mostly in rural and suburban areas with a population covered of more than 12.6 million people. Dobson was incorporated into our wireless operations subsequent to our acquisition. Our 2007 results included net revenue of $141 and expense of $109 from Dobson.

Wireless Customer and Operating Trends
As of December 31, 2007, we served 70.1 million wireless customers, compared to 61.0 million at December 31, 2006 and 54.1 million at December 31, 2005. Approximately 70% of our wireless customer net additions in 2007 were retail customer additions, and 75% of these additions were postpaid customer additions. Contributing to our net additions and retail customer growth was improvement in customer turnover (customer churn) levels due to our strong network performance and attractive products and services offerings, including the Apple iPhone, which were partially offset by a slowing growth rate of new wireless users reflecting a maturing domestic wireless industry. The improvement in churn levels benefited from network and customer service improvements and continued high levels of advertising. Also contributing to the increase in net additions was a significant increase in prepaid gross additions. Gross customer additions were 20.1 million in 2007, 19.2 million in 2006 and 18.5 million in 2005. Postpaid customer gross additions declined primarily due to higher postpaid market penetration and market maturation, as well as lower industry postpaid churn.

As the wireless industry continues to mature, we believe that future wireless growth will become increasingly dependent on our ability to offer innovative services, which will encourage existing customers to upgrade their current services and handsets and will attract customers from other providers, as well as on our ability to minimize customer churn. Average service revenue per user/customer (ARPU) increased 2.2% compared to 2006 primarily due to increased data services ARPU growth. In 2007, data services ARPU grew 46.9% compared to 2006. The continued increase in data revenue was related to increased use of text messaging, Internet access, e-mail and other data services, which we expect to grow as we continue expanding our third-generation (3G) services. The growth in data ARPU was partially offset by a decline in voice service ARPU of 4.1% compared to 2006, reflecting a higher percentage of prepaid and reseller customers, which provide significantly lower ARPU than postpaid customers, and continued shifts to all-inclusive rate plans that offer lower monthly charges. We expect continued pressure on voice service ARPU.

ARPU declined 1.1% in 2006 due to decreases in local service, net roaming and other revenue per customer mostly offset by a 44.8% increase in data ARPU and increased long-distance revenue per customer. In 2006, local service revenue per customer declined primarily due to the two reasons discussed above as well as free mobile-to-mobile plans that allow our wireless customers to call other AT&T Mobility customers at no charge and, to a lesser extent, Rollover® minutes. An increase in customers on Rollover plans tends to lower ARPU, since unused minutes (and associated revenue) are deferred until subsequent months for up to one year.

The effective management of customer churn also is critical to our ability to maximize revenue growth and to maintain and improve margins. Customer churn is calculated by dividing the aggregate number of wireless customers who cancel service during each month in a period by the total number of wireless customers at the beginning of each month in that period. Our customer churn rate was 1.7% in 2007, down from 1.8% in 2006 and 2.2% in 2005. The churn rate for postpaid customers was 1.3% in 2007, down from 1.5% in 2006 and 1.9% in 2005. The decline in postpaid churn reflects higher network quality, more affordable rate plans and broader network coverage as well as exclusive devices and free mobile-to-mobile calling among our wireless customers. Churn levels were slightly negatively impacted by ongoing transition of customers from our older analog and Time Division Multiple Access (TDMA) platforms to our advanced Global System for Mobile Communication (GSM) network. We plan to cease operating our analog and TDMA networks in early 2008. The increasing mix of prepaid and reseller customers in our customer base are also expected to pressure churn rates in the future.

Wireless Operating Results

Our wireless segment operating income margin was 16.4% in 2007, 12.2% in 2006 and 5.3% in 2005. The higher margin in 2007 was primarily due to revenue growth of $5,147, which exceeded our increase in operating expenses of $2,699. The higher margin in 2006 was primarily due to revenue growth of $3,069, which exceeded our increase in operating expenses of $324.

Service revenues are comprised of local voice and data services, roaming, long-distance and other revenue. Service revenues increased $4,890, or 14.5%, in 2007 and $3,115, or 10.2%, in 2006 and consisted of:

- Data revenue increases of $2,692, or 63.3%, in 2007 and $1,579, or 59.0%, in 2006. The increase in 2007 is primarily due to the increased number of data users and an increase in data ARPU of 46.9%, which primarily resulted from increased use of text messaging, e-mail, data access and media bundling services. Our significant data growth also reflects an increased number of subscribers using our 3G network. The increase in 2006 was related to increased use of text messaging and Internet access services, which resulted in an increase in data ARPU of 44.8%. Data service revenues represented approximately 18.0% of our wireless segment service revenues in 2007 and 12.6% in 2006.
- Voice revenue increases of $2,135, or 7.3%, in 2007 and $1,592, or 5.8%, in 2006. The increase in 2007 was primarily due to an increase in the number of average wireless customers of approximately 12.1%, partially offset by a decline in voice ARPU of 4.1%. The increase in 2006 was primarily due to an increase in the average number of wireless customers of 11.5%, partially offset by competitive pricing pressures and the impact of various all-inclusive calling and prepaid plans. Included in voice revenues for both periods were increases in long-distance and net roaming revenue due to increased international usage.

Equipment revenues increased $257, or 6.9%, in 2007 and decreased $46, or 1.2%, in 2006. The increase in 2007 was due to higher handset revenues reflecting increased gross customer additions and customer upgrades to more advanced handsets, partially offset by increased equipment discounts and rebate activity. The slight decrease in 2006 was due to a decline in handset revenues as a result of increased rebates and equipment return credits and lower priced handsets, mostly offset by increased sales of handset units, handset upgrades and accessories.

Cost of services and equipment sales expenses increased $934, or 6.2%, in 2007 and $669, or 4.6%, in 2006. The 2007 increase was primarily due to increased equipment sales expense of $1,140 due to the overall increase in sales as well as an increase in sales of higher-cost 3G devices, the introduction of the Apple iPhone handset and an increase in the number and per-unit cost of handset accessory sales. Total equipment costs continue to be higher than equipment revenues due to the sale of handsets below cost, through direct sales sources, to customers who committed to one-year or two-year contracts or in connection with other promotions.

Cost of services declined $206 in 2007. This decline was due to lower interconnect, roaming and long-distance expenses related to network and systems integration and cost-reduction initiatives, as well as cost reductions from the continued migration of network usage from the T-Mobile USA (T-Mobile) network in California and Nevada to our networks in these states. Our remaining purchase commitment to T-Mobile for this transition period was $51 at December 31, 2007. These decreases were partially offset by higher network usage, with increases in total system minutes of use (MOU) of 13.5%, and associated network system expansion and increased network equipment costs.

Expenses increased in 2006 primarily due to increases in network usage and associated network system expansion. Cost of services increased $492, or 5.3%, in 2006 due to the following:

- Increases in network usage with a total system MOU increase of 20.6% related to the increase in customers. Additionally, average MOUs per customer increased 8.2%.
- Higher roaming and long-distance costs, partially offset by a decline in reseller expenses. The reseller decrease resulted from a decrease in MOUs on the T-Mobile network of more than 50% for 2006.
- Integration costs, primarily for network integration, of $229.

Equipment sales expenses increased $177, or 3.5%, in 2006 due to increased handset upgrades of 11.2% and an increase in the average cost per upgrade and accessory sold, partially offset by a decline in the average cost per handset sold to new customers.

Dollars in millions except per share amounts

Selling, general and administrative expenses increased $1,148, or 10.0%, in 2007 and decreased $199, or 1.7%, in 2006.

The increase in selling, general and administrative expenses in 2007 was due to the following:

- Increases in selling expenses of $572 due to increases in sales and advertising expenses and Apple iPhone-related costs, partially offset by a decrease in net commission expense, which was consistent with the increase in prepaid plan sales as a percentage of total retail sales.
- Increases of $572 in customer service and other expenses primarily due to increased bad-debt expense of $338 and other support costs of $234, partially offset by a decline of $191 in billing expenses, lower information technology (IT) costs and customer service expenses.
- Increases in upgrade commission and residual expenses of $195 due to increased prepaid plan costs and higher handset upgrade activity.

The decline in selling, general and administrative expenses in 2006 was due to the following:

- Decreases in billing and bad-debt expense of $378 primarily due to fewer account write-offs and cost-savings related to transitioning to one billing system.
- Decreases in other administrative expense of $106 due to a decline in legal-related expenses, lower employee costs and employee-related benefits due to a decrease in the number of employees, lower IT and other professional services expense and a federal excise tax refund accrual.
- Decreases in customer service expense of $87 due to a decline in the number of outsourced call center professionals and lower billing expenses.
- Increases of $147 primarily related to increased prepaid card replenishment costs and higher migration and upgrade transaction costs.
- Increases in other expense of $129 due to higher warranty, refurbishment and freight costs.
- Increases in selling expense of $96 due to an increase in sales expense, partially offset by a decrease in net commission expenses. The decline in net commission expense was due to reductions in average activation and agent branding expense, partially offset by an increase in direct commission expense.

The expenses above also include merger integration costs of $123 in 2006, such as employee-termination costs, rebranding and advertising and customer service and systems integration costs.

Depreciation and amortization increased $617, or 9.5%, in 2007 and decreased $146, or 2.2%, in 2006. The increase in 2007 was primarily due to an increase of $1,522 in amortization of identifiable intangible assets related to our acquisition of BellSouth's 40% ownership interest, partially offset by declining amortization of identifiable AT&T Wireless Services, Inc. (AWE) intangible assets acquired by AT&T Mobility in 2004, which are principally amortized using the sum-of-the-months-digits method of amortization. Expenses also increased due to accelerated depreciation on TDMA assets and ongoing capital spending for network upgrades and expansion. The 2007 increase was partially offset by decreases in depreciation expense of $905 in 2007 due to certain network assets becoming fully depreciated and purchase accounting adjustments on certain network assets related to acquiring BellSouth's 40% ownership interest of AT&T Mobility.

The decline in 2006 was due to a decline in amortization expenses of $449 attributable to the AWE intangible assets mentioned above, which are amortized using an accelerated method of amortization. This decline was partially offset by an increase in depreciation expense of $303 in 2006 primarily due to depreciation associated with the property, plant and equipment related to ongoing capital spending for our GSM network, which was slightly offset by expense declines due to equipment that had become fully depreciated in 2006.

Wireline
Segment Results

				Percent Change	
	2007	2006	2005	**2007 vs. 2006**	2006 vs. 2005
Segment operating revenues					
Voice	**$41,630**	$33,714	$24,180	**23.5%**	39.4%
Data	**24,075**	18,317	10,783	**31.4**	69.9
Other	**5,872**	5,447	3,491	**7.8**	56.0
Total Segment Operating Revenues	**71,577**	57,478	38,454	**24.5**	49.5
Segment operating expenses					
Cost of sales	**30,214**	26,693	17,464	**13.2**	52.8
Selling, general and administrative	**16,180**	13,185	9,875	**22.7**	33.5
Depreciation and amortization	**13,411**	9,676	7,426	**38.6**	30.3
Total Segment Operating Expenses	**59,805**	49,554	34,765	**20.7**	42.5
Segment Income	**$11,772**	$ 7,924	$ 3,689	**48.6%**	—

Operating Margin Trends

Our wireline segment operating income margin was 16.4% in 2007, compared to 13.8% in 2006 and 9.6% in 2005. Our wireline segment operating income increased $3,848, or 48.6%, in 2007 and $4,235 in 2006 primarily reflecting the addition of BellSouth's operating results in 2007 and ATTC's operating results in 2006. Results for 2007 reflect lower expenses as a result of merger synergies and the addition of higher-margined operations of BellSouth, partially offset by merger-related charges and additional amortization expense on those intangibles identified at the time of our acquisitions of BellSouth and ATTC. Our operating income continued to be pressured by access line declines due to increased competition, as customers disconnected both primary and additional lines and switched to alternative technologies, such as wireless, VoIP and cable for voice and data. Our strategy is to offset these line losses by increasing non-access-line-related revenues from customer connections for data, video and voice. For example, we have the opportunity to increase wireless segment revenues if customers choose AT&T Mobility as an alternative provider.

Operating income and margins increased in 2006 primarily due to lower expenses as a result of merger synergies partially offset by additional amortization expense on those intangibles identified at the time of our acquisition of ATTC and lower voice revenue as a result of continued in-region access line declines due to the reasons mentioned above.

Voice revenues increased $7,916, or 23.5%, in 2007 and $9,534 or 39.4%, in 2006 primarily due to the acquisitions of BellSouth and ATTC. Included in voice revenues are revenues from local voice, long-distance and local wholesale services. Voice revenues do not include VoIP revenues, which are included in data revenues.

- Local voice revenues increased $6,831, or 38.4%, in 2007 and $826, or 4.9%, in 2006. The increase in 2007 was primarily due to the acquisition of BellSouth, which increased local voice revenues approximately $8,040. Local voice revenues also increased in 2007 due to pricing increases for regional telephone service, custom calling features and inside wire maintenance agreements. Local voice revenues in 2007 and 2006 were negatively impacted by expected declines in revenues from ATTC's mass-market customers to which no proactive marketing occurs and from customer demand-related declines for calling features and inside wire agreements. We expect our local voice revenue to continue to be negatively affected by increased competition, including customers shifting to competitors' alternative technologies and the disconnection of additional lines for DSL service and other reasons.
- Long-distance revenues increased $761, or 5.3%, in 2007 primarily due to the acquisition of BellSouth, which increased long-distance revenues approximately $2,075 and $9,256 in 2006, primarily due to the acquisition of ATTC. Contributing to the revenue increases in 2007 and 2006 were continuing higher long-distance penetration levels in our original 13-state region. These increases were primarily offset by a continuing decrease in demand for long-distance service, mostly due to an expected decline in ATTC's mass-market customers. Our long-distance revenue increase was also partially offset by competitive pricing for large-business customers and a decrease in demand for prepaid calling cards.
- Local wholesale revenues increased $324, or 20.9%, in 2007 and decreased $548, or 26.1%, in 2006. The increase in 2007 was primarily due to the acquisition of BellSouth, which increased local wholesale revenues approximately $615. Wholesale revenue decreased in 2007 and 2006 due to industry consolidation as certain customers moved more traffic to their own networks. We expect this trend to stabilize during 2008, absent additional consolidation.

Data revenues increased $5,758, or 31.4%, in 2007 primarily due to the acquisition of BellSouth, which increased data revenues approximately $5,230, and increased $7,534, or 69.9%, in 2006 primarily due to the acquisition of ATTC. Data revenues accounted for approximately 34% of our wireline operating revenues in 2007, 32% in 2006 and 28% in 2005. Data revenues include transport, IP and packet-switched data services.

IP data revenues increased $3,080, or 47.6%, in 2007 primarily due to the acquisition of BellSouth, which increased IP data approximately $2,235, and increased $3,044, or 88.7%, in 2006 primarily due to the acquisition of ATTC. Included in IP data revenues are DSL, dedicated Internet access, VPN and other hosting services. VPN, hosting and dedicated Internet access services contributed to IP data growth in 2007 and 2006 due to continued growth in the customer base and migration from other traditional circuit-based products.

Our transport services, which include DS1s and DS3s (types of dedicated high-capacity lines) and SONET (a dedicated high-speed solution for multisite businesses), increased $2,640, or 29.7%, in 2007 almost entirely due to the acquisition of BellSouth, which increased transport services revenues $2,730. In 2007, SONET and other transport data revenues increased due to continuing high-speed volume growth. These increases were almost entirely offset by DS1 and DS3 revenue decreases due to continuing industry pricing pressures and higher levels of customer adjustments. In 2006, transport services revenues increased $2,362, or 36.3%, primarily due to the acquisition of ATTC.

Our packet-switched services include frame relay, ATM and managed packet services and increased $38, or 1.3%, in 2007 primarily due to the acquisition of BellSouth, which increased packet-switched service revenues $265. This increase was almost entirely offset by both competitive pricing and lower demand as customers continue to shift to IP-based technology. We expect these services to continue to decline as a percentage of our overall data revenues. Packet-switched services increased $2,128 in 2006 primarily due to the acquisition of ATTC.

Other operating revenues increased $425, or 7.8%, in 2007 and $1,956, or 56.0%, in 2006. The increases were due to incremental revenue from our acquisitions of BellSouth in 2007 and ATTC in 2006. Major items included in other operating revenues are integration services and customer premises equipment, government-related services, outsourcing and state and municipal fees, which account for more than 67% of total revenue for all periods.

Equipment sales and related network integration and management services decreased $274 in 2007 and $176 in 2006 primarily due to less emphasis on the sale of lower-margin equipment. Revenue also decreased by $70 in 2007 due to the recognition of intellectual property license fees in 2006 that did not recur in 2007.

Cost of sales expenses increased $3,521, or 13.2%, in 2007 and $9,229, or 52.8%, in 2006. The increases were primarily due to incremental expenses resulting from our acquisitions of BellSouth in 2007 and ATTC in 2006. Cost of sales consists of costs we incur in order to provide our products and services, including costs of operating and maintaining our networks and personnel costs, such as salary, wage and bonus accruals. Costs in this category include our repair technicians and repair services, certain network planning and engineering expenses, operator services, information technology and property taxes related to elements of our network. Pension and postretirement costs, net of amounts capitalized as part of construction labor, are also included to the extent that they are associated with these employees.

In addition to the impact of the BellSouth acquisition, cost of sales in 2007 increased due to the following:

- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $605.
- Higher expenses of $225 in 2007 due to a 2006 change in our policy regarding the timing for earning vacation days, which reduced expense in 2006.
- Salary and wage merit increases and other bonus accrual adjustments of $165.

Partially offsetting these increases, cost of sales in 2007 decreased due to:

- Lower traffic compensation expenses (for access to another carrier's network) of $831 primarily due to migration of long-distance calls onto our network and a lower volume of calls from ATTC's declining national mass-market customer base.
- Lower net pension and postretirement cost of $398, primarily due to changes in our actuarial assumptions, including the increase of our discount rate from 5.75% to 6.00% (a decrease to expense) and favorable investment returns on plan assets resulting in a decrease in the recognition of net losses from prior years.
- Lower cost of equipment sales and related network integration services of $300, primarily due to less emphasis on sales of lower-margin equipment. Costs associated with equipment for large-business customers (as well as DSL) typically are greater than costs associated with services that are provided over multiple years.
- Lower expenses of $163 in 2007 due to the discontinuance of DSL Universal Service Fund fees in the third quarter of 2006.

In addition to the impact of the ATTC acquisition, cost of sales in 2006 increased due to the following:

- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $163.
- Higher benefit expenses, consisting primarily of our combined net pension and postretirement cost, increased expense $159, primarily due to changes in our actuarial assumptions, which included the reduction of our discount rate from 6.00% to 5.75% (which increases expense), and amortization of net losses on plan assets in prior years.
- Higher traffic compensation expenses (for access to another carrier's network) of $109 primarily due to increased volume of local traffic (telephone calls) terminating on competitor networks and wireless customers.

Partially offsetting these increases, cost of sales in 2006 decreased due to:

- A reduction in equipment sales and related network integration services of $418, primarily due to lower demand and as a result of the September 2005 amendment of our agreement for our co-branded AT&T | DISH Network satellite TV service. Prior to restructuring our relationship with EchoStar in September 2005, we had been recording both revenue and expenses for AT&T | DISH Network satellite TV customers, resulting in relatively high initial customer-acquisition costs.
- Lower employee levels, which decreased expenses, primarily salary and wages, by $296.
- A change made during 2006 in our policy regarding the timing for earning vacation days decreased expenses $225.
- Merger severance expenses in 2005 were higher than in 2006 by $176.
- In-region weather-related repair costs incurred in 2005 that did not recur in 2006, which decreased expenses $100 in 2006.
- Non-merger-related severance expenses in 2005, which were higher than in 2006 by $73.

Selling, general and administrative expenses increased $2,995, or 22.7%, in 2007 and $3,310, or 33.5%, in 2006. The increases were primarily due to incremental expenses resulting from our acquisitions of BellSouth in 2007 and ATTC in 2006. Selling, general and administrative expenses consist of our provision for uncollectible accounts; advertising costs; sales and marketing functions, including our retail and wholesale customer service centers; centrally managed real estate costs, including maintenance and utilities on all owned and leased buildings; credit and collection functions; and corporate overhead costs, such as finance, legal, human resources and external affairs. Pension and postretirement costs are also included to the extent that they relate to those employees.

In addition to the impact of the BellSouth acquisition, selling, general and administrative expenses in 2007 increased due to the following:

- Salary and wage merit increases and other bonus accrual adjustments of $102.
- Higher expenses of $96 in 2007 due to a 2006 change in our policy regarding the timing for earning vacation days, which reduced expense in 2006.
- Higher provision for uncollectible accounts of $80.

Partially offsetting these increases, selling, general and administrative expenses in 2007 decreased due to:

- Lower net pension and postretirement cost of $243, primarily due to changes in our actuarial assumptions, including the increase of our discount rate from 5.75% to 6.00% (a decrease to expense) and favorable investment returns on plan assets resulting in a decrease in the recognition of net losses from prior years.
- Lower employee levels, which decreased expenses, primarily salary and wages, by $222.
- Lower nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs, of $148.

In addition to the impact of the ATTC acquisition, selling, general and administrative expenses in 2006 also increased due to the following:

- Other wireline segment costs of $809 primarily due to advertising costs related to promotion of the AT&T brand name. In addition, other advertising expenses increased $117.
- Higher nonemployee-related expenses, such as contract services, agent commissions and materials and supplies costs of $103.
- Higher benefit expenses, consisting primarily of our combined net pension and postretirement cost, increased expense $73, primarily due to changes in our actuarial assumptions, which included the reduction of our discount rate from 6.00% to 5.75% (which increases expense) and net losses on plan assets in prior years.

Partially offsetting these increases, selling, general and administrative expenses in 2006 decreased due to:

- ATTC merger-related asset impairment charges of $349 and merger-related severance expense of $107 during 2005, which resulted in lower expenses in 2006.
- Lower employee levels, which decreased expenses, primarily salary and wages, by $239.
- A charge of $236 in 2005 to terminate existing agreements with WilTel Communications due to our acquisition of ATTC.
- A change made during 2006 in our policy regarding the timing for earning vacation days, which decreased expenses $96.
- Our provision for uncollectible accounts decreased $87, as we experienced fewer losses from our retail customers and a decrease in bankruptcy filings by our wholesale customers.

Depreciation and amortization expenses increased $3,735, or 38.6%, in 2007 and $2,250, or 30.3%, in 2006 primarily due to higher depreciable and amortizable asset bases as a result of the BellSouth acquisition in 2006 and the ATTC acquisition in 2005.

Supplemental Information

Access Line, Broadband Connections and Video Connections Summary Our in-region switched access lines at December 31, 2007, 2006, and 2005 are shown below and access line trends are addressed throughout this segment discussion. Because our acquisition of BellSouth has a significant effect on comparative information, we have included pro-forma amounts below as of 2006 for comparative purposes, as if the companies had been combined.

Wireline In-Region[1]

(in 000s)	**Actual 2007**	Pro Forma 2006	Actual 2006	Actual 2005
Switched Access Lines				
Retail Consumer	**35,047**	37,120	25,308	26,683
Retail Business[2]	**22,754**	23,295	16,714	16,871
Retail Subtotal[2]	**57,801**	60,415	42,022	43,554
Percent of total switched access lines	**93.9%**	90.9%	90.7%	88.1%
Sold to ATTC	**242**	1,293	1,044	1,638
Sold to other CLECs[2,3]	**3,288**	4,431	2,991	3,886
Wholesale Subtotal[2]	**3,530**	5,724	4,035	5,524
Percent of total switched access lines	**5.7%**	8.6%	8.7%	11.2%
Payphone (Retail and Wholesale)[4]	**251**	330	250	335
Percent of total switched access lines	**0.4%**	0.5%	0.6%	0.7%
Total Switched Access Lines	**61,582**	66,469	46,307	49,413
Total Broadband Connections[2,5]	**14,156**	12,170	8,538	6,921
Satellite service[2,6]	**2,116**	1,507	689	513
U-verse video	**231**	3	3	—
Video Connections	**2,347**	1,510	692	513

[1]Wireline in-region represents access lines served by AT&T's incumbent local exchange companies (ILECs).
[2]Prior period amounts restated to conform to current period reporting methodology.
[3]Competitive local exchange carriers (CLECs).
[4]Payphone lines are presented above as previously reported. Revenue from these lines is reported in the Other segment.
[5]Broadband connections include DSL, U-verse high-speed Internet access and satellite broadband.
[6]Satellite service includes connections under our agency and resale agreements with EchoStar and DIRECTV.

Dollars in millions except per share amounts

Advertising & Publishing
Segment Results

				Percent Change	
	2007	2006	2005	**2007 vs. 2006**	2006 vs. 2005
Total Segment Operating Revenues	**$5,851**	$3,685	$3,684	**58.8%**	—
Segment operating expenses					
Cost of sales	**1,733**	1,121	1,104	**54.6**	1.5
Selling, general and administrative	**1,333**	616	581	**—**	6.0
Depreciation and amortization	**924**	3	5	**—**	(40.0)
Total Segment Operating Expenses	**3,990**	1,740	1,690	**—**	3.0
Segment Operating Income	**1,861**	1,945	1,994	**(4.3)**	(2.5)
Equity in Net Income (Loss) of Affiliates	**—**	(17)	(5)	**—**	—
Segment Income	**$1,861**	$1,928	$1,989	**(3.5)%**	(3.1)%

Ingenio Acquisition
In December 2007, we acquired Ingenio®, a provider of Pay Per Call® technology. Ingenio will be integrated with YPC and will allow us to better serve business directory and local search customers across our entire advertising and publishing portfolio.

Accounting Impacts From the BellSouth Acquisition
Prior to the BellSouth acquisition (see Note 2), we accounted for our 66% economic interest in YPC under the equity method since we shared control equally with BellSouth. Following the BellSouth acquisition, YPC became a wholly-owned subsidiary of AT&T and its results are reflected in operating revenues and expenses in our consolidated statement of income.

For segment disclosure purposes, we have carried forward deferred revenue and deferred cost balances for BellSouth in order to reflect how the segment is managed. This is different from consolidated reporting purposes as under FAS 141 BellSouth deferred revenue and expenses from directories published during the 12-month period ending with the December 29, 2006 acquisition date are not recognized and therefore were not included in the opening balance sheet (see Note 4). For management reporting purposes, we continued to amortize these balances over the life of the directory (typically 12 months). Thus, our advertising & publishing segment results include revenue of $964 and expenses of $308 in 2007 related to directories published in the Southeast region during 2006, prior to our acquisition of BellSouth.

Operating Results
Our advertising & publishing segment operating income margin was 31.8% in 2007, 52.8% in 2006 and 54.1% in 2005. The decrease in the segment operating income margin in 2007 was primarily due to the addition of BellSouth's operating results, including the amortization of BellSouth's customer lists acquired as a part of the acquisition. The decrease in the segment operating income margin in 2006 was primarily the result of increased operating expenses.

Operating revenues increased $2,166, or 58.8%, in 2007, primarily due to the addition of BellSouth's operating results, which increased operating revenues approximately $2,220 in 2007. The increase was largely driven by print advertising revenue of $1,859 and Internet advertising revenue of $200. Operating revenues in 2006 remained relatively unchanged.

Operating expenses increased $2,250 in 2007 compared to $50, or 3.0%, in 2006 primarily due to the addition of BellSouth's operating results, which increased total operating expenses by approximately $2,110 in 2007. The increase in 2006 was primarily due to higher costs for Internet traffic, brand advertising and employee benefits.

Cost of sales increased $612, or 54.6%, in 2007 compared to $17, or 1.5%, in 2006, primarily due to the addition of BellSouth's operating results, which increased cost of sales by approximately $550 in 2007. Publishing, commissions, paper and printing costs represent the majority of cost of sales expenses in 2007. The increase in 2006 was primarily due to higher costs for Internet traffic.

Selling, general and administrative expenses increased $717 in 2007 compared to $35, or 6.0%, in 2006 primarily due to the addition of BellSouth's operating results, which increased selling, general and administrative expenses by approximately $645 in 2007. Employee, uncollectible and advertising-related expenses represent the majority of selling, general and administrative expenses in 2007. Increased expenses in 2006 were primarily due to increases in other advertising & publishing segment costs, including brand advertising and employee benefits of $102, partially offset by lower bad-debt expense of $74.

Depreciation and amortization expenses increased $921 in 2007, resulting from the amortization of customer lists acquired as a part of the BellSouth acquisition, which increased expenses by $915 in 2007. Depreciation and amortization expenses in 2006 remained relatively unchanged.

Other
Segment Results

				Percent Change	
	2007	2006	2005	**2007 vs. 2006**	2006 vs. 2005
Total Segment Operating Revenues	**$2,234**	$1,878	$1,731	**19.0%**	8.5%
Total Segment Operating Expenses	**1,827**	1,485	1,248	**23.0**	19.0
Segment Operating Income	**407**	393	483	**3.6**	(18.6)
Equity in Net Income of Affiliates	**676**	2,020	629	**(66.5)**	—
Segment Income	**$1,083**	$2,413	$1,112	**(55.1)%**	—

Our other segment operating results consist primarily of Sterling, customer information services, corporate and other operations. Sterling provides business-integration software and services. In late 2007, we announced our intention to cease our retail payphone operations by the end of 2008, which is reflected in the operating revenues and expenses discussion below.

Operating revenues increased $356, or 19.0%, in 2007 and $147, or 8.5%, in 2006. The increase in 2007 was primarily due to the addition of BellSouth's other operations and increased operating revenue at Sterling, partially offset by decreased revenues from our retail payphone operations. The increase in 2006 was primarily due to increased intercompany revenue from our captive insurance company (shown as intersegment revenue in Note 4) and improved operating revenue at Sterling, partially offset by a decrease in revenue as a result of the sale of our paging subsidiary in November 2005.

Operating expenses increased $342, or 23.0%, in 2007 and $237, or 19.0%, in 2006. The increase in 2007 was primarily due to the addition of BellSouth's other operations and increased operating expenses at Sterling, partially offset by decreased expenses from our retail payphone operations. The increase in 2006 was primarily due to increased operating expenses at Sterling and at our captive insurance company, partially offset by management fees paid in 2005 that did not recur in 2006.

Prior to the December 29, 2006 close of the BellSouth acquisition, our other segment included our 60% proportionate share of AT&T Mobility results as equity in net income of affiliates. As a result of the BellSouth acquisition, we own 100% of AT&T Mobility and its results for the final two days of 2006 and for the year 2007 have been excluded from equity in net income of affiliates in this segment and in our consolidated statements of income.

Our other segment also includes our equity investments in international companies, the income from which we report as equity in net income of affiliates. Our earnings from foreign affiliates are sensitive to exchange-rate changes in the value of the respective local currencies. Our foreign investments are recorded under GAAP, which include adjustments for the purchase method of accounting and exclude certain adjustments required for local reporting in specific countries. Our equity in net income of affiliates by major investment is listed below:

	2007	2006	2005
América Móvil	**$381**	$ 274	$198
Telmex	**265**	222	212
AT&T Mobility	**—**	1,508	200
Other	**30**	16	19
Other Segment Equity in Net Income of Affiliates	**$676**	$2,020	$629

Equity in net income of affiliates decreased $1,344 in 2007 primarily due to a change in accounting for AT&T Mobility, the results of which are no longer included in equity in net income of affiliates in 2007 due to the acquisition of BellSouth. This decrease was partially offset by an increase of $150 from América Móvil and Telmex primarily due to improved operating results. Equity in net income increased $1,391 in 2006, primarily due to the improved operating results at AT&T Mobility.

OPERATING ENVIRONMENT AND TRENDS OF THE BUSINESS

2008 Revenue Trends We expect continued expansion of our operating revenues in 2008, reflecting continuing growth in our wireless and broadband/data services. We expect our primary driver of growth to be wireless and that all our major customer categories will continue to increase their use of Internet-based broadband/data services. For our enterprise (largest) business customers, we achieved positive growth in recurring service revenues beginning in the third quarter of 2007 and expect total enterprise revenues to grow throughout 2008. Revenue growth will also reflect the increased information and technology services to be provided for under our agreements with IBM. We also expect continued revenue growth from our small and medium business customers. We expect modest growth in our consumer wireline revenues with continuing declines in traditional access lines being offset by growth in broadband and video services. We expect solid growth in broadband revenues with improvement in ARPU as customers continue to choose higher-speed services. We expect to continue to expand our U-verse service offerings with the goal of exceeding one million subscribers in service by the end of 2008.

2008 Expense Trends Acquisition and related merger costs and the costs involved in providing services under the IBM agreements will adversely affect expenses in 2008. We expect that our operating income margin, adjusted to exclude these costs, will expand in 2008 due primarily to expected improvement in our revenues and continued cost-control measures. In particular, we expect to continue net workforce reductions and other previously identified merger synergies and to begin new cost-control initiatives in network operations, information technology and customer care. Expenses related to growth initiatives (see "Expected Growth Areas") will apply some pressure to our operating income margin.