Dear Fellow Employee:

This is the time of year we close our books and survey the results of 12 months of hard work.

As you know, some of those results already are public knowledge. Our earnings statement was distributed and printed in various media. More recently, our Annual Report to shareholders was distributed to all owners of AT&T shares.

You may have read the earnings statement or the full Annual Report. However, the ways in which the financial data are reported are directed more toward the financial community than the average employee. Therefore, I thought a special view of our 1973 achievements for employees—with particular emphasis on the meaning of the financial data—might prove useful. This report has been prepared especially for all Bell employees in that interest.

During 1973, we accomplished the major goals we set at the beginning of the year. The following pages describe some of the ways in which we got the job done.

However, I want to note here that no accounting of dollar figures or service results can begin to describe our achievements. The real story lies in the spirit of determination of thousands of telephone people to strive for goals just a bit higher than seem reasonable of attainment.

That spirit of determination has never been more in evidence than during 1973, and as a result, we improved our service position and our financial condition.

As I have noted before, the public—customers, investors and competitors—are recognizing more and more these days that the Bell System is alive and well.

For this, and for the continuing spirit of commitment I see wherever I visit with Bell System people today, I offer my deepest gratitude and congratulations.

J. D. deBUTTS

AT&T Chairman of the Board
Introduction

We began the year with five major goals in mind: (1) to improve service, (2) to improve efficiency, (3) to improve earnings, (4) to improve opportunities for Bell System people to grow, and (5) to develop public understanding of the basic policies that we believe are essential to good service.

Throughout the year, we made extremely gratifying progress on all of these fronts.

Improved service and efficiency

In 1973, usage of Bell System services increased nine per cent over 1972. And although we increased our volume of service to this level with only a two per cent increase in employees, we nonetheless achieved excellent levels of efficiency.

Calling Volumes Up

Over 432 million calls were handled on an average business day, an increase of 22 million calls daily over 1972. Long distance calls increased 11% to 9.5 billion for the year.

Despite increased traffic, our service goals were met consistently. For example, our target of three seconds or less for the time it takes customers to get a dial tone was met 99 per cent of the time.

Customer reports of trouble also decreased. For each 100 telephones we served, trouble reports dropped from 5.2 per cent in 1972 to 5.0 per cent last year.

We also increased our efficiency in direct distance dialed calls. Long distance calls dialed directly by our customers were completed 66 per cent of the time on the first attempt; of the remaining 34 per cent, virtually all were "busy signals" or "no answers."

While telephone people were meeting these and other service goals, they also were supplying another kind of service which is indispensable to our future. This service transcends technical proficiency and depends ultimately on the courtesy, the personal consideration, the attention to little things that telephone people demonstrate in their transactions with the public.

Although this kind of service cannot be measured numerically, the reactions of all of our publics tell us that it is one in which telephone people achieved outstanding results in 1973.

Improved employee opportunities

Bell System Companies made excellent progress in 1973 toward continued growth of capabilities and opportunities for all employees. Some 100,000 telephone people took advantage of job enrichment programs designed to expand the scope and the challenge of their assignments.

In addition, more than 14,000 employees participated in Systemwide programs that assist the companies in identifying future managers of the business. Of that number, about half were women, and one in five were minority employees. These important programs will help assure the increased representation on higher levels of management of women and members of minority groups in the years ahead.

Our determined efforts to assure equal opportunity throughout our business resulted in new distributions of employees in many job categories in 1973.

For example, the percentage of minority employees in highly-technical craft jobs increased 50 per cent during
the three years since 1970, and the number holding management jobs increased 60 per cent.

The overall number of minority employees in our companies rose from 96,000 to 118,000, and today some 10,000 of these minority employees hold management jobs.

Women also registered impressive gains. Largely as a result of efforts to open new opportunities through our Upgrade and Transfer Plan, the number of women in craft jobs traditionally held by men stood at approximately 11,000 at the end of 1973, compared to 2,100 at the end of 1970. Women accounted for 33 per cent of management employees—about 64,000 management jobs—at year's end.

What became increasingly clear this year is that we have no male jobs, no female jobs, no black jobs, no white jobs. What we do have is a policy that values the ability to perform the work, and the dedication to doing one's best at the job.

**Improved income**

1973 was an excellent year financially for the Bell System. Our income from operations—called operating revenues—rose to a new record of more than $23.5 billion, an increase of 13 per cent over 1972.

To generate this record figure, Bell System people furnished more than $11 billion of local telephone service and $11 billion of toll service. Almost $1 billion in additional income was generated from directory advertising and other sources.

There are several useful ways to examine the total income figures for the Bell System. The most traditional is the approach recorded in the Annual
Reinvested Earnings 4.8%
Interest 7.2%
Dividends 7.4%
Taxes 18.1%
Depreciation and Other 27.5%

Distribution of Income*

Report, which provides a financial breakdown of the figures in considerable detail. We shall examine the figures in this way a bit later on.

First, however, it may be interesting to examine the figures in terms of the main ways in which our operating revenues and other income are used.

There are six major categories of income distribution.

The first and largest is payroll expense, which in 1973 accounted for 35 per cent of our income. Payments to our employees are constantly growing, having increased 63 per cent since 1969 both because of an increase in the number of employees and higher rates of pay.

Revenues Increased
BILLIONS
in Operating Revenues

The second largest area is listed as "Depreciation and Other" expenses. Depreciation is the cost to a company of the gradual loss in value of its physical assets, resulting from physical wearing out of equipment or from its becoming obsolete. "Other" expenses are for supplies and services. This year, "Depreciation and Other" expenses

*Excludes profit from sale of Comsat stock
accounted for 27.5 per cent of our income.

The third area is taxes, which accounted in 1973 for 18.1 per cent of our income. We pay taxes on sales, equipment, purchases, real estate, supplies, revenues and dividends. Federal income tax is the largest single tax the Bell System pays.

The fourth area is interest, amounting to 7.2 per cent of income this year. Interest is paid as a return on investment to the individuals and institutions who lent us money.

Fifth is dividends, which are paid to the three million people who have invested in AT&T stock. In 1973, the dividend declared for shareholders amounted to $2.87 per common share, and these dividends equated to 7.4 per cent of income.

The balance of our operating revenues—4.8 per cent—was reinvested back into the business, mostly in construction expenditures.

The amount paid in dividends, combined with the reinvested earnings, is what is ordinarily considered profit.

A more detailed view of the numbers

Now that we have a good idea of the total income figures for 1973 and the ways, at least in broad terms, that the dollars were distributed, it may be useful to examine the financial results as reported in the Annual Report.

Operating expenses

Total operating expenses, a category which includes payroll costs, depreciation, and other items, amounted to 62.5 per cent of Bell System income. The Annual Report gives the total expenditures for major operating functions. The largest operating expense item is $4.83 billion, spent in maintaining the telephone system. Depreciation amounted to $3.33 billion.

A total of $1.82 billion was attributed to Traffic, primarily for handling messages. Marketing was just under $1 billion, followed by Commercial and Accounting, for which $814 million and $649 million was spent respectively.

Another major operating expense was the provision for pensions and other employee benefits, which in 1973 amounted to more than $1.65 billion. For pensions and death benefits, payments are made to trust funds irrevocably devoted to those purposes.

Together with miscellaneous operating expenses, the total operating expenses for 1973 amounted to just over $15 billion. Subtracting these expenses from our total revenues, our net operating revenues came to some $8.53 billion.

Taxes

The largest expenditure charged against net operating revenues was our total operating taxes, which amounted to $4.35 billion. These taxes, for federal, state and local governments, do not include the dollars collected in sales and excise taxes, or the taxes we paid on purchases or withheld from employees.

After subtracting operating taxes from our net operating revenues, the Company's operating income was reduced to $4.18 billion.

This amount was increased by over $500 million in "other income," mainly from Western Electric Company.

Taxes and Income

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<th>BILLIONS</th>
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<tr>
<td>Net Operating Revenues</td>
</tr>
<tr>
<td>Federal, State, Local Taxes</td>
</tr>
<tr>
<td>Operating Income</td>
</tr>
<tr>
<td>Other Income</td>
</tr>
<tr>
<td>Operating and Other Income</td>
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</tbody>
</table>

Net income

The net income figure was arrived at by first subtracting interest deductions—primarily the amount of interest paid to the owners of our debt obligations. These deductions totaled $1.73 billion, reducing income to $2.95 billion. Then we added the $46.6 million profit, after income taxes, from the sale of the Company's 2,596,000 shares of Communications Satellite Corporation stock.

The result was net income of $2.99 billion.

In addition to being expressed as a total number (in everyday terms it's called profits), net income is reported as earnings per common share of stock. After deducting $186 million for dividends to owners of preferred shares, our earnings per common share, based on 554 million average shares outstanding in 1973, amounted to $5.06. These earnings included 8¢ per share from the sale of Comsat stock. Therefore, our earnings from operations were $4.98 per share.
Arriving at Net Income or Profits

**BILLIONS**

Operating and Other Income $4.681
Interest on Debt — 1.734
Sale of Comsat Stock + .046
Net Income $2.993

Another Look at Profits:

**Earnings Per Share**

**BILLIONS**

Net Income $2.993
Dividends to Owners of Preferred Shares — .186
Income Applicable to Common Shares $2.807
Based on 554 Million Average Outstanding Shares
(DOLLARS)
From Operations $4.98/share
Sale of Comsat Stock + .08/share
Total $5.06/share

Where Net Income Goes

**BILLIONS**

1.6 billion declared in dividends to owners of common shares
1.2 billion to support construction programs

Distribution of net income

Each year, the Bell System’s net income is divided in two ways: first, dividends are paid to owners of preferred and common shares; second, the balance is reinvested in the business, mainly to support construction costs.

In 1973, almost $1.6 billion was declared in dividends to owners of common shares, and another $192 million to preferred share owners.

The remainder of our $1.2 billion of net income was retained in the business.

Assets of the Bell System

To meet our service obligations, the Bell System carried out a construction program in 1973 unmatched in scale by any private enterprise in the world. Our construction expenditures, totaling more than $9.3 billion, financed, among other things, the addition of 31 million circuit miles to our nationwide network of transmission facilities and an increase in call-switching capacity sufficient to serve a city twice the size of Chicago.

This investment brought the total telephone plant at year’s end to a value (cost) of $74 billion.

In calculating asset value of the Bell System, accumulated depreciation was subtracted from total plant. Accumulated depreciation at year’s end amounted to nearly $15.4 billion, leaving a net plant investment of $58.6 billion.

The company’s investments, its current assets (including net cash and temporary cash investments, receivables, materials and prepaid expenses) and its deferred charges were then added to the remainder to determine overall assets.

At the end of 1973, the total asset value of the Bell System was just over $67 billion.

**Assets**

**BILLIONS**

$9.3 billion in construction brought telephone plant to $74.0
Accumulated Depreciation — 15.4
Net Plant Investment $58.6
Company’s Investments and Current Assets (cash, receivables, etc.) + 8.4
Total Assets $67.0

Liabilities and Capital

The liabilities and capital of the Bell System precisely equals its asset value.

There are five major categories of information which comprise this section of the Company’s Annual Report.

The first is Equity, which totals the preferred and common shares, reinvested earnings, and minority ownership interest in consolidated subsidiaries. The equity total for 1973 was $31.2 billion.

The second category, Long and Intermediate Term Debt, totals the sums raised through issuing debentures and bonds, primarily for the expansion or construction of plant. This category of debt at year’s end totaled more than $26.7 billion.

Interim Debt, the third category, refers to debt due within one year. This debt amounted to about $1.7 billion.
Long and Intermediate Debt

Total $67 Billion in Liabilities

Liabilities and Capital

BILLIONS

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<thead>
<tr>
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<th>1973</th>
<th>1972</th>
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<tr>
<td>INCOME</td>
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<tr>
<td>Local services</td>
<td>$11,419</td>
<td>$10,363</td>
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<tr>
<td>Toll services</td>
<td>11,278</td>
<td>9,771</td>
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<tr>
<td>Other</td>
<td>1,334</td>
<td>1,218</td>
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<td>$24,031</td>
<td>$21,352</td>
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<td>EXPENSES</td>
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<td>21,084</td>
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<td>INCOME BEFORE EXTRAORDINARY ITEM</td>
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<td>$2,532</td>
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<td>EXTRAORDINARY ITEM*</td>
<td>.46</td>
<td>.46</td>
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<td>NET INCOME</td>
<td>2,993</td>
<td>2,532</td>
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<td>DIVIDENDS DECLARED</td>
<td>1,783</td>
<td>1,633</td>
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<td>EARNINGS REINVESTED IN THE BUSINESS</td>
<td>$1,210</td>
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<td>EARNINGS PER COMMON SHARE</td>
<td>dollars</td>
<td>dollars</td>
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<tr>
<td>Before extraordinary item</td>
<td>$4.98</td>
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<tr>
<td>Extraordinary item*</td>
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<td>.08</td>
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<tr>
<td>Total</td>
<td>$5.06</td>
<td>$4.34</td>
</tr>
</tbody>
</table>

*Sale of Company's Comsat shares

Other Current Liabilities, the fourth category, amounted to $4.2 billion at year's end. This includes such items as amounts payable to employees and suppliers and interest owed to owners of debt securities.

The final major item, Deferred Credits, totaled $3.2 billion for the year. The major items in this category are deferred income taxes and unamortized investment tax credit.

Together, these items totaled just over $67 billion, equaling the asset value of the company.

Summary of financial data

An annual report must present a broad array of numbers in order to be complete. In addition, those numbers must be described in some cases in terms which are not necessarily familiar to all of us.

However, the financial results can be summarized into areas of particular interest to employees and to investors.

The table at left summarizes these areas, and thus summarizes the "Improved Earnings" section of this report.

A perspective on our improved earnings

Our rate of earnings on average capital—the most comparable measure of profits among companies whose investment requirements are different—rose to 8.3 per cent in 1973, up from 7.7 per cent a year earlier. While this increase is gratifying, it still falls short of the 9.5 per cent return we believe is needed to attract new investment money on reasonable terms. Our aim is to improve earnings sufficiently to reach that goal.
Our momentum in that direction appears to be gathering. Of the 21 principal operating companies, 18 improved their ratio of return last year over 1972 levels.

This improvement was made possible in part by state regulatory authorities in 33 jurisdictions which, in 1973, authorized increases in telephone rates that will add about $1 billion annually to Bell System revenues.

It should be noted that this rate relief was provided in recognition of the effects of persistent inflation on the telephone companies, and of our responsibility to undertake and finance major plant expansion.

It should also be noted that even with the rate increases, the cost of local telephone service has risen only 24 per cent since 1960, as compared to an increase of 55 per cent in the Consumer Price Index.

Rate of Return
Our increase in the rate of earnings on total capital from 7.7 to 8.3 per cent was gratifying but falls short of the 9.5 objective needed to attract new investment money on reasonable terms.

A special challenge
Whether measured in terms of improved service, greater opportunities or bottom line figures, 1973 was a good year for the Bell System.

However, it was also a year in which we confronted a serious challenge to a most basic principle upon which our business has been built. This foundation of our business—called the common carrier principle—gives us and 1,700 other telephone companies an exclusive responsibility by the government to serve the public, subject to regulation by government agencies in such matters as rates and quality of service.

This principle, which underlies our ability to provide highly efficient telephone service at reasonable costs, is being challenged today.

A number of regulatory decisions over recent years have opened our business to increased competition, most notably in the market for terminal equipment and in the interstate private line field.

Permitted to compete on equal terms in these markets, the Bell System will give a good account of itself. But what is becoming increasingly clear is that it is not a free and open competition, but rather a regulated market allocation between ourselves and others. The crucial point is that the others are free to serve selected segments of the market that are profitable, but they do not share our responsibility to serve the entire market.

In the long run, this kind of competition will harm the average American user by increasing the price he must pay for service and by lowering the quality of that service.

During 1973, we concluded that whenever and wherever the further extension of this kind of segmented and selected competition is proposed without sufficient examination of its impact on the public, our obligation to our customers requires us to oppose it.

This we have begun to do. The two most important issues arising last year in this regard were (1) "certification" of customer-provided communications equipment, and (2) further entry in the market for interstate private line services of the so-called specialized common carriers.

There may be those who contend that our opposition to further competition in the telecommunications industry is directed solely by a desire to protect our markets and our earnings. But our real concern is for the adverse impact on service quality and charges for all telephone users.

Conclusion
The process of summing up our achievements for the past year leads quite naturally to surveying the demands and the opportunities of the year ahead.

We know now that this year will be no less rigorous than the past one in its requirements that we conduct our operations in as lean and efficient manner as we know how. We must continue to improve service. We must meet the challenge of competition head on, a task we have begun already by shaping a comprehensive new marketing strategy and by an information program to inform telephone employees and the public of the issues.

1974 will not be an easy year for the Bell System. There will be new challenges to meet, new problems to be overcome. Yet, in each of these challenges and in every problem, there will be opportunities for telephone people to enhance their own abilities and to grow.

We are committed to a year-to-year rate of improvement in all the areas vital to the public and to the Bell System. We will undoubtedly keep that commitment in 1974.