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Sprint Corp. (S)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Jud Henry
Head-Investor Relations

GAAP AND NON-GAAP FINANCIAL MEASURES

- Turning to Slide three, throughout our call, we will refer to several non-GAAP metrics
- Reconciliations of our non-GAAP measures to the appropriate GAAP measures for the quarter can be found on our Investor Relations website

Earnings

- Let's move on to earnings for our Q3 2015 on slide four
- Sprint's net loss improved $1.5B or $0.39 per share y-over-y to a net loss of $836mm or a loss of $0.21 per share compared to a net loss of $2.4B or a loss per share of $0.60 in the year-ago period
    - This improvement was related to better adjusted EBITDA which Tarek will discuss in more detail, partially offset by higher depreciation expenses related to leased devices
- In addition, there are some one-time items in both periods including severance and exit costs primarily related to workforce reductions in the current quarter of $209mm while the year-ago quarter include a

non-cash asset impairment of $2.1B partially offset by $726mm or $0.18 per share non-cash tax benefit from the aforementioned impairment charge
  - Adjusting for these one-time items, net loss per share would have improved $0.8 y-over-y

R. Marcelo Claure

President, Chief Executive Officer & Director

BUSINESS HIGHLIGHTS

Transformation Plan

- This quarter marks a big step forward in our turnaround effort at Sprint and we're progressing on our plan to return Sprint to profitability, subscriber growth, and network parity or superiority
- I'm very excited about the momentum that Sprint is building across all aspects of our transformation plan

NET ADDITIONS AND POSTPAID CHURN

- First of all, postpaid phone net additions were the highest in three years and we've had the highest postpaid net ports on record
- At the same time, we had our best ever postpaid churn for fiscal third quarter in the company's 20-year history in wireless and the biggest y-over-y improvement in churn in over 12 years

COST REDUCTION EFFORT, OPERATING REVENUES AND ADJUSTED EBITDA

- We continue to build momentum in our cost reduction effort with an early $800mm improvement YTD in cost of service and selling, general and administrative expenses
- And our operating revenues are now stable at $8B a quarter and expected to grow next year
- Together our adjusted EBITDA trajectory's improving and as a result we're raising our FY2015 adjusted EBITDA guidance to $7.7B to $8B.
- In addition, we see momentum continuing into next year and our preliminary estimate for FY2016 adjusted EBITDA is likely to be in the range between $9.5B to 10B

MOBILE LEASING SOLUTIONS

- As it relates to funding our turnaround, we closed our first sale-leaseback transaction with Mobile Leasing Solutions or handset LeaseCo receiving $1.1B in cash in December as well as increasing the capacity of our receivable facility by $1B at the same time
- In addition, our network is performing better than ever for both voice and data according to reputable third parties who measure network performance including RootMetrics and Nielsen

Subscriber Growth

POSTPAID NET ADDITIONS

- Turning to slide six, Sprint continues to build momentum in subscriber growth
- As you can see reflected in our third quarter results, we have 491,000 total net additions in the quarter, which brings us to over 2mm total net additions YTD as continued progress in postpaid has offset the pressures of the prepaid business

- Postpaid net additions of 501,000 were the highest in four years compared to net additions of only 30,000 in the prior year quarter which makes five consecutive quarters of postpaid growth

POSTPAID CHURN

- We continue to make tremendous progress reducing our postpaid churn which was the best for a fiscal third quarter in Sprint's history this quarter at 1.62% improving by 68BPS y-over-y
- Remarkably, our last three quarters are the lowest churn quarters in the company's history which speaks to the continued improvement in our network and the improved quality of customers we're now attracting
- Most importantly, in the highest profit contribution category for business, our postpaid phone net additions of 366,000 were the highest in three years and marks the second consecutive quarter of net additions
- This quarter results also improved sequentially for the seventh consecutive quarter
    - This represents a progressive improvement of over 1mm net additions from the nearly 700,000 phone losses seven quarters ago to the 366,000 additions this quarter

PREPAID NET LOSSES

- Prepaid net losses in the quarter were 491,000 compared to net additions of 410,000 a year ago driven by increased competitive intensity in the prepaid as well as fewer promotions from Sprint prepaid brands as we have prioritized higher profit postpaid growth
- Also our wholesale business continues to grow
- For the tenth consecutive quarter we had net additions of 481,000

Network

RELIABILITY CAPACITY AND SPEEDS

- Now let me update you on our progress on the network on slide seven
- Our network is performing at best-ever levels across the board and we're delivering our goal of providing a network that delivers a consistent reliability capacity and speeds that our customers demand
- Despite some speculation in the press, we're executing on the same plan that we laid out previously to enhance our network through a small-cell focused densification
- Our network team has been very busy this year leading Sprint to have the most improved network with more spectrum deployed on LTE per customer than any other national carrier to provide our customers speed and capacity now and especially in the future

NEW LTE PLUS NETWORK

- Our new LTE Plus network is now in more than 150 markets across the country and takes advantage of our rich spectrum position coupled with technology enhancement like carrier aggregation and antenna beamforming to create wider channels producing more capacity and faster speeds and better [indiscernible] (07:25) performance
- You don't have to just take our word for it
- Either [indiscernible] (07:29) performance data from Nielsen, the world's foremost authority on independent measurement, now shows that Sprint's LTE network is delivering the fastest LTE download speed compared to Verizon, AT&T and certainly T-Mobile
    - This matters in a big way because Nielsen looks at how real customers are actually experiencing the network based on a panel of volunteers representing more than 270mm consumers

LTE DOWNLOAD SPEEDS

- It does with this app that continuously monitors performance on their phones measuring LTE download speeds for common application such as Facebook, Netflix, YouTube, Snapchat, et cetera
- This crowd sourced data is always working uninterrupted in the background to show us exactly what wireless consumers are experiencing
- Bottom line, over 75mm downloads collected from real customers in cities across the country showed that Sprints win where it matters, the actual customer experience
- You can expect us to be more vocal about our great network as well
- We now have 13 2x20 carrier aggregation enabled devices available to our customers comprising 76% of our postpaid phone sales in the quarter and making up 21% of our postpaid phone base at the end of December
    - When you couple that with the fact that 64% of our postpaid phone base has drive on LTE capable devices, our customers are now enjoying the breadth of coverage and capacity that our network team has worked so hard to deliver
    - It's not just our speed either

RootMetrics

- As you can see on slide eight, our network is performing at best-ever levels across voice and data as evidenced by independent mobile analytics firm RootMetrics across 125 markets in H2 2015
- Sprint's 212 Metro RootScore awards were the most in company's history and Sprint was by far the most improved carrier including receiving more RootScore awards than T-Mobile
- Even where Sprint may not have come in first in many cases, we have closed the gap vs. the market leader to where the difference are likely non-noticeable to consumers
- RootMetrics show our voice network performing at best-ever levels with our lowest ever dropped call rate and highest ever voice reliability

DATA PERFORMANCE

- Meanwhile, the testing of our data performance show our average download speed across 125 markets has more than tripled in the last two years while our data reliability increased from a year ago as well
- Furthermore, our time on LTE is now at an all-time high of 94%
    - This an important indicator of the customer experience as it measures how much of the time is spent using data is on LTE vs. prior generation platform like 3G

DIVIDENDS

- This significant improvement in the network today is paying dividends in the form of a better customer experience and obviously lower churn
- Günther and John have put a huge emphasis on the customer experience with everything we do with our network, making sure the customer experience on the network gets better every day and avoiding any disruption to the customer whenever possible in everything that they do

Densification and Optimization Strategy

- Looking to the future in slide nine, we're proud of how far the network has come and we're excited to continue to take it to even higher levels as we continue progressing towards our densification and optimization strategy, focus on densifying our network and optimize it for custom performance

- This includes bringing LTE Plus to even more markets and further unlocking the power of our spectrum position
- We're also excited by the early progress on densification plans to further differentiate our network in the future, which has primarily been focused on activities for our small cell deployments to date
    - We're deploying these small cells using crowd sourced data that will enable us to be more surgical in delivering stronger signals to address a specific customer pain point
    - The best part is that this will be a progressive build whereby the customer experience will only improve as each incremental site comes on air
    - We do not expect a disruption to their service from existing sites as this is not a rip and replace strategy

CAPITAL AND OPERATING COST

- We continue to be focused on maximizing network performance as well as efficiency of capital and operating cost with the cost to build and operate these densification sites being materially less than our macro site builds in the past
- We're very confident that this densification and optimization strategy will deliver the capacity, speed, and coverage to position Sprint for network parity or superiority over the next two years. [Indiscernible] (11:56) our unique depth of spectrum will be the best position of all carriers for the growing data demands of the future

Pricing

- Moving to slide 10, Sprint continues to offer the best price for data on the network that is better than ever before
- However, perception in the market still lacks reality on both account
- Our customers are experiencing a network that's faster than the competition and there has never been a better time to give Sprint a try
- We're so proud of our LTE Plus network that we launch a promotion offering 50% off the price of most Verizon, AT&T and T-Mobile rate plans during the biggest switching period of the year to invite more customers to come try Sprint

CUSTOMER DEMAND

- The results of the offer exceeded our expectation in terms of customer demand and the number of lines per account that were coming in which led us to extend the offer for another month as you probably saw
- Obviously part of the decision to extend the offer was the validation of the financial value creation that this offer delivered
- When we look at the loading of new customers in Q3 compared to the same quarter last year, we estimate that the average customer life value of this year's addition are 33% higher than a year ago

MARKETING SPEND

- Furthermore, we estimate that our share of industry postpaid phone gross adds increased by 150BPS y-over-y to the highest level in nearly three years while also delivering the highest postpaid net ports against competitors on record
- We expect future growth to come primarily from better execution and accountability with greater efficiency in our marketing spend and establishing a new regional accountability model of the sales force, we're putting the resources closer to the customer to improve sales, productivity and retention

  - We trialed this model in Chicago with great success and now we're excited to see what it can deliver nationwide

PROFITABILITY

- Only now we're focused on providing a competitive price to customers while still growing the average billings per user to drive profitability
- Furthermore, we continue to maintain a selective approach to customer acquisition, focus a lot more on the quality of customers than the absolute quantity as we look to maximize long-term value and progress toward sustainable cash flow
- Given the higher customer lifetime values of prime and multi-line customer, this is the most cost effective way to acquire new customers while continue to delight our existing customers and lowering our postpaid churn over time

Tarek A. Robbiati
Chief Financial Officer

FINANCIAL HIGHLIGHTS

Net Operating Revenue

- Moving to revenue on slide 11, consolidated net operating revenue was $8.1B for the quarter and most importantly has now stabilized at around $8B for the last three quarters and grew 2% sequentially
- Services revenue of $6.7B for the quarter were down 8% y-over-y due to a higher mix of customers in the postpaid base now on rate plans offered in conjunction with device financing programs as well as lower wire line revenue

WIRELESS SERVICES REVENUE

- Looking at wireless services revenue on a more comparable basis, service revenues plus installment billings and lease revenues of $7.1B actually increased 1% y-over-y. 65% of postpaid device sales in the quarter were financed, which is consistent with the prior two quarters and compares with device financing take rates of 46% a year ago
- This quarter, roughly 55% of postpaid sales selected our leasing plans, which was up slightly from last quarter
- The Sprint platform postpaid average total billing per account, which includes the monthly equipment installment billings and lease revenue and service revenue per account, was $167.11 for the quarter
  - This represents a 4% increase y-over-y as higher installment billings and lease revenues more than offset the lower monthly service charges offered in conjunction with device financing options as well as the fact that our average lines per account has increased 5% y-over-y

POSTPAID PHONES AND PREPAID ARPU

- Looking at postpaid phones specifically, postpaid phone ABPU of $70.99 for the quarter increased 3% y-over-y, maintaining price discipline for future profitability and growing the monthly cash flow stream from our customers
- Prepaid ARPU of $27.44 increased 1% y-over-y primarily driven by changes in the mix of our customer base among our prepaid brands

Operating Expenses

- Regarding our operating expenses on slide 12, we are focused on transforming the cost structure of the business to a more nimble competitor and more importantly to get the FCF generation
- As it stands, we are exceeding our original targets for reduction in FY 2015, which are funding the many turnaround initiatives we are implementing to attract and retain customers and improve the overall customer experience

COST OF SERVICES AND SG&A

- We have already realized nearly $800mm in net reductions YTD across cost of service and selling, general and administrative expenses alone
- Cost of services of $2.3B was flat y-over-y, but it is important to note that network costs were actually lower by more than $100mm y-over-y offset by increases related to the cost to support our service and repair of devices for our customers
- YTD cost of services is better by $85mm with network costs better by over $400mm largely offset by higher service and repair costs
- Our selling, general and administrative expenses were $2.1B in the quarter and improved by over $500mm y-over-y primarily driven by lower bad debt expense as a result of our:
    - Improved customer credit profile
    - Lower marketing spend
    - And general and administrative expense reductions
- YTD selling, general and administrative expenses are lower by almost $700mm compared to last year

COST OF PRODUCTS

- Cost of products of $1.6B improved by almost $1.4B from a year ago primarily related to lower retail sale volumes and higher adoption of device leasing options for which the associated cost was recorded as a depreciation expense
- YTD, our cost of products are lower by over $3B compared to last year
- We expect further y-over-y improvement in our operating expenses in the fiscal fourth quarter as well

Operating Expenses

- Turning to slide 13, we have raised the bar further for 2016, as we mentioned last quarter
- We are confident in our plan to achieve a sustainable reduction of $2B or more of run rate operating expenses exiting FY2016
    - This reduction is expected to be a reduction in cash operating expenses and not subject to reinvestment unless funded by further reductions
    - I remember someone writing a few months ago that they had never seen a carrier that successfully cut cost, improved the network and grow subscribers at the same time
    - Well, that is exactly what we're doing

POSTPAID PHONE ADDITIONS

- Our operating expenses keep coming down, our network is performing at best-ever levels, and we have posted two consecutive quarters of postpaid phone additions while delivering the three lowest churn quarters in the company's history

- We are confident that we can continue to execute on all three at the same time with a guiding principle that changes that we make in the operating model must be executed in a way that minimizes any disruption to the sales momentum we are achieving or the customer experience

EXPENSE REDUCTIONS

- Now let me put some meat on the bone for where you will see the $2B of exited run rate expense reductions come from in rough orders of magnitude
- Roughly 10% of the savings is expected to come from cost of products through better logistics and procurement
- Between 20% and 30% of the reduction is expected to come from cost of services driven by migrations from TDM to IP in the wireline business as well as lower roaming expenses and rent expense reductions from the WiMAX shutdown in the wireless business
    - By far, we expect the bulk of the reductions will come from selling, general and administrative expenses across a number of initiatives

Sales, Marketing Expenses and Customer Care Costs

- Sales will improve as a result of improving the channel mix of sales and improved execution in our stores
- Marketing expenses will improve as a result of cutting sponsorships such as the NBA and NASCAR to better target those resources to customers including local marketing in addition to better efficiencies in our market placement
- Customer care costs are expected to come down as a result of coal volume reductions and improved handled times through easier access to better self-service tools for the customers
- IT expenses will improve through reduced hardware and software maintenance and the improved operation efficiencies across these functions will pave the way for significant labor reductions across all of the back office support functions within general and administrative expenses
    - I also want to remind you that to realize these run rate benefits, we expect some one-time transformation program operating costs and CapEx costs to be required

OpEx and CapEx

- Our current estimates of such transformation program costs including program OpEx and CapEx for the business are approximately $1B split fairly between OpEx and CapEx and with the exception of the severance expense this quarter, most of the transformation costs are now expected to be incurred in FY 2016
- Altogether, there are hundreds of initiatives underway that we are confident can deliver the $2B or more run rate savings as we exit FY 2016
- While the ramp-up of the reductions will vary by initiative and by P&L line, this hopefully gives you a clear picture of where we expect to see the benefits on a run rate business

Adjusted EBITDA

- Now turning on slide 14, our adjusted EBITDA was $1.9B for the quarter compared to $1B a year ago as the expense reductions that I discussed more than offset the decline in operating revenue
- Operating loss of $197mm includes $209mm of severance and exit costs and compares to an operating loss of $2.5B in the year-ago quarter as the higher adjusted EBITDA that I just discussed was partially offset by higher depreciation expenses associated with the growing base of device leases

- In addition, there are significant one-time items that Jud mentioned earlier in the call with the severance and exit costs of $209mm in the current quarter and $2.1B non-cash impairment partially offset by $726mm associated tax benefit a year ago
    - When adjusting for these one-time items, operating loss would have improved by approximately $400mm y-over-y

CapEx and Cash Flow

- Turning to CapEx and cash flow on slide 15, cash CapEx s were $1.6B in the quarter consistent with a year ago as the increase in spending related to device leasing in our indirect channels offset lower capital spending on the network benefiting from software driven deployments of capacity through carrier aggregation
- Cash flow was negative $797mm for the quarter compared to a negative $1.8B in the year-ago quarter
    - The y-over-y change was driven by the improved operating results that I discussed as well as $800mm received under our receivable facility in the quarter
- Our reported FCF does not include the $1.1B in proceeds from the sale and leaseback transaction with Mobile Leasing Solutions in December which actually helped increase our ending cash balance by $200mm from last quarter despite our highest quarter of device sales this year and continued network investment

Liquidity

- Shifting focus to liquidity on slide 16, we ended the quarter with total general purpose liquidity of $6B comprised of cash, cash equivalents and short-term investments of $2.2B, $3B of undrawn borrowing capacity under our revolving bank credit facility and $800mm of undrawn capacity under our receivable facility at the end of the quarter
- In addition, we had $600mm in undrawn availability under our network vendor financing to be utilized towards the purchase of 2.5 gigahertz network equipment with another $500mm becoming available in April

MOBILE LEASING SOLUTIONS

- As previously communicated, we completed the first sale and leaseback transaction with Mobile Leasing Solutions providing $1.1B cash infusion as well as creating a repeatable structure for the company to mitigate the working capital impacts associated with a leasing model
- We expect to execute future tranches generally on a quarterly basis and expect this structure to provide $3B to $4B of funding in FY 2016 depending on the amount of leasing sales
- We also expect future tranches to be done on balance sheet to simplify the impact to the financial statements for investors

RECEIVABLE FACILITY

- In addition, we amended our existing receivable facility to include the sale of future lease receivables thus increasing the maximum funding limit by $1B to a total of $4.3B
- These lease receivables are related to devices not included in the aforementioned transactions with Mobile Leasing Solutions
- Furthermore, we are establishing a network related financing entity in cooperation with SoftBank and its partners
- We expect that the network financing entity can provide between $3B to $5B of cash in FY 2016

- This facility is expected to include new assets associated with the network densification as well as raising proceeds against our existing radio access equipment and a portion of our spectrum portfolio

OPERATING EXPENSE REDUCTIONS

- When you combine the operating expense reductions, our existing liquidity sources and future tranches under both handset LeaseCo and the network financing entity, we have a well-defined liquidity strategy underway
- We expect that we will have adequate sources to provide all the capital necessary to fund the business and address the debt maturities between now and the end of FY 2016

GUIDANCE

Adjusted EBITDA

- Now let's look at guidance on slide 17
- Regarding our adjusted EBITDA guidance for FY 2015, we are raising our guidance from the previous range of $6.8B to $7.1B and now expect adjusted EBITDA to be between $7.7B and $8B
  - This increase in guidance is primarily due to accelerating the cost reduction initiatives with some benefits beginning to come in Q4 and the fact that we no longer expect to incur material one-time transformation cost in FY 2015 as the timing of those costs shifts into FY2016

OPERATING REVENUES AND COST REDUCTIONS

- In addition, as Marcelo mentioned, our preliminary estimate for FY2016 adjusted EBITDA is between $9.5 to $10B driven by growing operating revenues supported by service revenues that we expect to stabilize as we exit 2015
- In addition to the significant cost reductions that I discussed in detail, we will provide formal adjusted EBITDA guidance on our next earnings call at year-end

OPERATING INCOME

- Furthermore, we are also raising our operating income for FY2015 from an operating loss of $50mm to $250mm
- We now expect operating income of between a positive $100mm to $300mm based on the same drivers as adjusted EBITDA

CAPITAL EFFICIENCY

- In addition, as we remain focused on maximizing our capital efficiency while continuing to improve the performance of the network, we continue to expect cash CapEx to be approximately $5B for FY 2015, excluding the CapEx associated with purchasing lease devices in indirect channels

QUESTION AND ANSWER SECTION

Philip A. Cusick
JPMorgan Securities LLC

Q

Where to start? So I guess two things, if I can. First on SG&A decline, can you help us understand sort of where that comes from and break out the different pieces? The marketing part you mentioned NASCAR and the NBA. What is the expected reduction from net debt and how that can go forward into the fiscal fourth quarter? And then second, if you can talk a little bit more about the $3B to $5B network facility. What's the impact on the secured ratios and how big is the portion of the spectrum portfolio being used as collateral for that facility? Thanks.

Tarek A. Robbiati
Chief Financial Officer

A

Good morning, Philip. This is Tarek speaking. Thanks for these questions, the first one with respect to the SG&A decline and the second one on the network entity. With respect to SG&A, the SG&A encompasses sales, marketing, customer care, IT and in general all functional areas that support the business. So when you look at the sales reductions, we have left no stone unturned. In sales, we're driving productivity through an improved channel mix and better retail productivity in our own channels. In marketing, we have cut sponsorships that didn't really map to our brand, and we are more efficient in our media spend.

With respect to customer care, we are really driving the volume of customer care down without affecting customer experience. We're eliminating all sorts of unused – unuseful calls. In IT, we are reducing our hardware and software maintenance. And again, across all overhead functions, whether it's finance, whether it's legal, whether it's HR or corporate comps, we have been driving productivity. With respect to the network entity, it is very important for us to continue to retain ownership on the spectrum. Right now we have different alternatives in plan that we are evaluating.

What's really important for us are the terms at which this entity would provide funding for Sprint. And these terms are very much a function of what's in that entity and how we're going to be putting spectrum into it. Needless to say, there will be a very small amount of spectrum put into it. Spectrum is strategic. The future of Sprint hinges on our ability to leverage the full spectrum we have and make it available to all our customers so there will be a very, very small amount. Let me remind you, we have about more than 200mm, excuse me, 200 megahertz of spectrum across the bands that we possess. We will only use a very small portion of this to be part of the network entity.

Philip A. Cusick
JPMorgan Securities LLC

Q

And can you give us an idea of how these facilities impact your secured capacity?

Tarek A. Robbiati
Chief Financial Officer

A

Yes. So our secured capacity is very much dictated by what we call the consolidated net tangible assets. This capacity, you can do the math, but it's around $8.5B as of the 31st of December 2015. So when you look at that, you have to also net the revolver off that level. And we believe that under the terms that we currently have in our revolver, the network entity should not eat into that capacity and comes on top.

Michael I. Rollins
Citigroup Global Markets, Inc. (Broker)

Q

If I could just follow up with some questions on your network strategy. You provided some thoughts during the presentation this morning, but if you can give us a bit more thought given the questions that were raised over the last week and change around how you're looking to deploy the densification of cells. Are you looking to shrink the network at all in the coming months or years? And then maybe give us more thought on how you drive savings from the network. You mentioned roaming, you mentioned WiMAX, in the past you've mentioned backhaul. If you can give us just more thought on all of those points that would be great. Thank you.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

I'll start. It's Marcelo, and then I'm going to pass it to John Saw, our CTO. A couple of things about our network: First and foremost, we're focused on a densification and optimization strategy. We've been very clear that we're going to do that without jeopardizing the customer experience. And the way we're expanding our network is we're utilizing something that we call the lowest cost structure. So for all the new structures that we need, we basically look at what is available to us in order for us to deploy our equipment. We look at towers, we look at build to suit, we look at rooftops, we look at our own mono poles and we look at different pole attachments and then we choose what is the most efficient way for us to expand. Everything that we're doing is going to be to make our network a lot more dense. And obviously, what is very different this time than our previous network deployment is by no means this is a rip and replace. What this is is basically every single time that we light up a new site, then basically our network gets better progressively.

Now I'm going to pass it on to John, see if he wants to add.

John C. B. Saw
Chief Technology Officer

A

So, Mike, John here. With regards to your question on cost savings for the network, we are looking at a number of opportunities. First and foremost, there's opportunity in backhaul to reduce our backhaul costs, and we're going to be leveraging a hybrid approach of dark fiber and using wireless backhaul as well. And as you probably know, we run one of the largest microwave network in the U.S. today based on the network that we acquired from Clearwire, and we're also testing the potential use of our own 2.5 gigahertz spectrum for backhauling small cells, which we believe is a lot more cost efficient and surgical to get to our customers rather than trench fiber and be limited by that.

The other opportunity is obviously roaming. We intend to overbuild high roaming areas and reduce our roaming costs that way. We're also working with our CCA partners in the rural area markets for extending our LTE footprint. As Marcelo has mentioned, we are going to be very opportunistic to look at opportunities to optimize our antennas on lower cost infrastructure to reduce operating costs. This could include pole attachments, rooftops, macro sites of public infrastructure that deliver similar or better performance at lower costs. And the other opportunity also is in wireline where we are working to convert the more expensive TDM circuits to Ethernet. So those are some examples, Michael.

Jennifer M. Fritzsche
Wells Fargo Securities LLC

Q

Just to follow up on Mike's comments, just on the – I want to just be clear. On the sites which you've already upgraded to Network Vision, in that whole kind of rip and replace period, is it fair to say those will remain intact? And then secondly, if you could talk a little bit, Marcelo, about the people coming to your stores. Are they really

driven by your price and that's what's swinging the door inward to you, but are they then moving to higher data plans? Or can you talk a little bit about the experience you're getting and then the customers you're getting? Are you kind of penetrating the family plan for AT&T and Verizon? If you could talk a little bit more color there, that'd be helpful.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Great. Thank you, Jennifer. So our fundamental value proposition is we like to keep things simple. It's a great product at a great price, and we are achieving that. As you've seen, our network is performing better than ever, and therefore I think the best way to validate that is our churn. Customers from AT&T, Verizon and T-Mobile are coming. We have just recorded our highest porting quarter on record, meaning we're able to attract customers from all the three carriers. They're coming. They're liking the network, and they're staying. As it relates to price, we made it very clear that we're going to be a price leader. We're pretty bold in terms of offering 50% off our competitor rate plans. And after they have been with us for 24 months, they're going to go back to a standard rate plan. We can do that because we see our network getting better every time.

When we do that, a lot of people have questioned the profitability. And the way we measure profitability is called customer life value. And about all the new customers that we brought in in fourth quarter, the customer life value is 33% higher than last year. We're having higher average lines per account, meaning we have a lot of families that are coming.

And more importantly is the way we measure how we're performing in the market is SOGA, or the share of gross adds, for that specific month. And December, according to our records, was the first month that we surpassed 20% share of gross adds. That's a substantial improvement when August of last year we were at 10% share of gross adds. So we've gone from 10% to 20% according to our own records. So we have another metric that we measure is, are there any returns, meaning are customers coming and trying our network, especially from AT&T and Verizon, and we haven't had any material change in return volumes.

So bottom line, we will continue with our value proposition, which is a great product at a great price. Better said, a better network for less. Thank you.

Jennifer M. Fritzsche
Wells Fargo Securities LLC

Q

Then John, could I just ask on the Network Vision side? Thank you.

John C. B. Saw
Chief Technology Officer

A

Sure, Jennifer. With regards to our sites, first of all, Jennifer, let me just say that it's not surprising that there's a lot of speculation about our network plans out there and what we plan to do when we say we're going to densify the network. Today we will tell you as much as we want to tell you. At the same time, I want to make sure that we don't give our playbook away. With regards to sites, just let me point out that most of our leases are long-term leases, five to seven years. We are well aware of our contractual obligations with the tower companies. And we're not exiting existing leases today. We expect to continue to have a strategic relationship with the tower companies for many years to come, and they are an integral part of our network and will continue to be a strategic partner.

Amir Rozwadowski
Barclays Capital, Inc.

Q

So my first question I'd love to ask you folks is that you've provided a great deal of color around your liquidity availability along with the framework on how to think about the benefits associated with your current handset and pending network LeaseCo. If we take all of those elements together, can you provide us some color at least directionally about your cash flow expectations for the business and perhaps when we could expect you folks to be able to get to a sustainable level of cash generation?

Tarek A. Robbiati
Chief Financial Officer

A

Good morning, Amir. Thanks for asking that question. Needless to say, we understand the importance to get to a FCF positive as soon as possible. And we have a plan to get there, and we're executing it. As we said in the past calls, 2015 will be the peak cash flow burn, and we expect to substantially improve our company's cash position in the future. At this stage, we're not providing a specific date today as to when we will be FCF positive because we need to monitor the timing of the expense reductions and how they trickle down to the bottom line. And also we need to be mindful of the timing of our capital deployment as we continue to densify our network.

Nonetheless, we expect continued progressive improvement. As we continue to add postpaid net adds and the churn continues to go down, we will be on a upward trajectory as far as FCF is concerned.

Amir Rozwadowski
Barclays Capital, Inc.

Q

Thank you very much.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Let me add one quick thing. One of the things that we're measuring is our ability to basically neutralize the cash burn of devices. And if you take into consideration and if you measure this quarter, we were total cash flow positive after proceeds from handset LeaseCo. And what is unique is that now we're prepared to do more tranches on a per-needed basis of handset LeaseCo. As you grow, you obviously will burn cash, especially when you're leasing Apple devices and Samsung devices. So what we have now is we have found a way to finance our business that after we increase our sales of handsets, we immediately now have the capacity and the knowhow in terms of how to execute more tranches on handset LeaseCo, and that's how we intend to basically manage our business for an area of the business that usually burns a lot of cash.

Amir Rozwadowski
Barclays Capital, Inc.

Q

Thank you very much, Marcelo. And then if I may, last quarter you had discussed some thoughts around the conversion that was taking place between prepaid and postpaid subscribers. How should we think about that trajectory currently and going forward? Do you have a significant migration taking place, or how should we think about the momentum around the postpaid dynamics?

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Thanks for your questions. So last quarter we reported on what we call our Sprint prepaid customers that we started to extend them credit. Those numbers have gone through the roof. So we have decided to not report on those due to the fact that it might have caused some confusion. So we have reverted back those customers and categorized them as prepaid customers. The only what you've seen today for handset net adds that were positive handset net adds that were, I would say pretty good growth coming from last quarter are mainly true postpaid

handset net additions. We have a small group of customers that actually migrated from Boost and Virgin, but they actually migrated to the Sprint brand and that was I think about 24,000, so less than 10% of our total handset net additions. Our great handsets were I think in top of 350,000 and we've decided not to record those as postpaid so you can measure improvement y-over-y and to not cause any confusion.

Brett Joseph Feldman
Goldman Sachs & Co.

Q

Earlier, Marcelo, when you were talking about your pricing strategy, that the attractive price promotions you have in the market eventually revert back to full pricing once a customer has stayed with you for a period of time. There's definitely some concern among investors that your existing customer base are looking at those promotions and going to want access to those price points even if it's just for a promotional period. And so the question is what are you hearing from your existing customers? Are they asking to move into those prices? Are there other things you need to do from them? The real question is, is there any potential risk, at least in the near term, to the ARPU trend you've been reporting? Thank you

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Thank you. Our existing customers are finding out that they already have the best price, and customers that have been with us for a while, they're very satisfied with the quality of the network and all the improvements that they're experiencing. I think the best way to measure that is churn. If you look at what we've done in churn, it has been three consecutive quarters in which we had had the best churn in Sprint's 20-year wireless history. So we're measuring that and we're monitoring all of the sentiments of our customers, and so far, any customer that comes to us, we basically show them that they have the absolute best price. Don't forget that we come from a pretty large base of unlimited customers, and when you look at the price that our customers are sitting on unlimited, it is significantly less than any rate plan from our competitors including T-Mobile or AT&T that went back to offer unlimited. We feel very good the way we're managing our base. I think our base is happy. And the best story of that is that the constant churn reductions that we have been experiencing.

Jonathan Chaplin
New Street Research LLP (US)

Q

Two quick questions for Dr. Saw, if I may. Dr. Saw, you said you're not getting out of any tower leases that you're currently under contract on. But as your leases expire, can you give us some indication of how many of those you might be able to not renew and replace with alternative infrastructure? And then on the thought process behind using 2.5 gigahertz to backhaul small cells, how much of your capacity – how much spectrum would you – if you're using 60 megahertz over the year, how much do you need in order for the purposes of backhaul? And then a quick question for Tarek, it sounds like the spectrum that backs the facility you can't use. That's what it sounded like from your comments. I'm wondering if you could just clarify that.

Tarek A. Robbiati
Chief Financial Officer

A

Okay. Let me just start with the last bit of the question. No, the spectrum that we intend to put in a network facility will be available for us to use. This is really important. As I articulated in my prior answer to an earlier question, we will retain ownership of that spectrum. This is absolutely critical not just from a having it on balance sheet, but also being able to use it.

Jonathan Chaplin
New Street Research LLP (US)

Q

Perfect.

Tarek A. Robbiati
Chief Financial Officer

A

John, could you take the rest?

John C. B. Saw
Chief Technology Officer

A

Hey, Jonathan. With regards to your questions on tower leases, like I said, most of our leases are long-term leases, five to seven years. It's too early to speculate what we're going to do, and so I'm not going to do that. As we look at densifying our network and as we add more sites, we're always looking for opportunities to optimize our costs including looking for lower-cost infrastructure to attach our antennas. So that's the path that we're taking. With regards to 2.5 gigahertz backhaul, as you know we have an average of 160 megahertz or 194 megahertz of 2.5 spectrum in the markets but that's a lot of spectrum that we can use for carrier aggregation as well as for backhauling small cells.

In terms of how much we're going to be allocating to that, we're still doing field tests right now, so we will get a better feel for the numbers later. But I'm very confident that with our backhaul strategy of using dark fiber at [indiscernible] (48:48) sites, using microwave radios for backhauling certain sites, and then for small cells, being very surgical and precise in locating it using our own spectrum at 2.5 gigahertz, I think we have a very low cost and very efficient backhaul plan.

Jeffrey Kvaal
Nomura Securities International, Inc.

Q

I have a question for you about the trajectory of churn over time. I think one of the things that came out of the conference call last week from one of your rivals was that the lack of non-iconic phones really had an impact on this particular quarter. And I'm wondering to what extent that may have rippled through for you. Obviously iPhone is not necessarily as big for you as for others and what that really, and really then, what that tells us about the trajectory of churn and some of your other metrics into 2016. Thank you.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Thanks Jeffrey. I mean, we're doing quite well with inventory from our two main vendors, from Apple and Samsung. So that didn't have any effect on churn. We have a strategic relationship with both. So I don't see basically how. I think all carriers had all the necessary inventory. I think it was one of the best executed Apple launches, so we feel very good that that didn't have any effect, and we're getting ready for the traditional launches that happen now. And we'll be properly prepared. And we'll be continuously innovating the way we do. I think iPhone Forever has had a tremendous success of customers that like to upgrade their phone once a year. We feel very good about the future churn for all of our customers who are on an iPhone Forever due to the fact that they will upgrade while they're still under contract.

So if you look at the trajectory of the wireless industry, the normal way was the customers sign a two-year agreement. They were out of their two-year, and they want to upgrade. What is very different on iPhone Forever and all the programs that we have is the customer has an 18-month or a 24-month agreement but they're able to upgrade inside their agreement and therefore renewing their agreement for another 18 months or 24 months. So we're looking at this program to basically allow us to even lower churn further.

As it relates to our churn performance, we had a reduction of 68BPS. I think that's one of the best y-over-y improvement, if I'm not mistaken, it's the best y-over-y improvement in the last 12 years. So we feel very good about that. And I think again I'll go back to the basics. If you're offering a great product at a great price, your customer will stay and hopefully we're going to continue to attract more customers. As I said, we've had the best boarding I think in company's history in this last quarter.

Jeffrey Kvaal
Nomura Securities International, Inc.

Q

Marcelo, thanks. You also answered my follow-up question there as well. Let me be a little bit tighter then in my follow-up and to say, to what extent do you think we – are you able to give us a sense of how churn should improve over the course of the next few quarters? 68% is exceptionally impressive. I wouldn't imagine that that would sustain. What levels might we be thinking of?

R. Marcelo Claure
President, Chief Executive Officer & Director

A

I mean, I don't want to give you a number because what I tell my team every day is great job in bringing churn down, but we're still fourth. So I look at it we're going to continue to launch new programs and we want to get closer to our competitors and I want to get to a number that's below to what we have. But I'm not prepared right now to give you a churn number as it's hard to anticipate, especially with a competitive market that we have today.

Mike L. McCormack
Jefferies LLC

Q

Maybe just circling back on I guess it was maybe Jennifer's question regarding the ARPU of the customers coming in, whether they're buying up for data, when you're calculating the customer lifetime value benefits, is it anticipated that we'll see – or is the calculation based on better ARPU than your Sprint legacy subscribers? And then what churn rate do you use to calculate those numbers?

R. Marcelo Claure
President, Chief Executive Officer & Director

A

What was that? What churn rate do we use to calculate those numbers? I mean, let me go back and tell you that the customers that we're bringing in today, especially with the 50% promotion, there are lots of customers who actually choose a plan that is not 50% off but it is a plan that is very similar to what they're paying but what they're doing is they're getting additional data. Furthermore is we're seeing a lot of multi-line customers, plus we start measuring the average billing per account, we've seen that that has increased our average billing per account, which is quite important.

And then when we look at our average billing per user in handsets, we see that that is increasing. So let me give you some more numbers. Our postpaid average billing per account was $167.11, which is up 4% y-over-y and that basically reflects the growth that we're having. Our ABPU, for average billing per user, was up 3% y-over-y. So we're pretty much happy with the type of customers that we're bringing, and like I said, our customer life value of the new customer that we're bringing in this quarter was 33% higher than measured to the same cohort of customers that we were bringing this same time last year.

Mike L. McCormack
Jefferies LLC

Q

So I guess then, Marcelo, as we look into the calendar first quarter numbers, the anticipation would be that we wouldn't see ARPU, handset ARPU pressures even in the face of the half-off promotion then? So the decline rate getting better.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Yeah. I think ARPU is an outdated figure that it's really hard to measure because as we're transitioning customers from a traditional subsidy model to a model where they're paying or they're leasing their device, it's really hard to measure ARPU. The way we measure ARPU or performance at Sprint is our average billing per user, which basically that takes into consideration your handset revenue plus your service revenue and in addition, we have other customers that we have to take into consideration the residual value of the device at the end of the lease. And so far, as you know I think in that area, we hold a competitive advantage through a strategic alliance with Brightstar, which is the largest reseller of used devices. So we're happy with the quality of customers that we're bringing, and we're happy with the amount of customers that we're bringing.

Mike L. McCormack
Jefferies LLC

Q

Okay. I was just trying to get a sense. I think service revenue is still very important with respect to looking at promotional activities and the 50% off promotion, just seeing if that will have a less negative impact as we go through, first quarter, second quarter, CY 2016 which is of interest.

Jud Henry
Head-Investor Relations

A

Mike, I would point you back to the comments we made earlier which was when we gave those forward-looking view, we said we expected that service revenues will stabilize as we exit 2015 and move into 2016.

Mike L. McCormack
Jefferies LLC

Q

All right. Okay.

Tarek A. Robbiati
Chief Financial Officer

A

Michael, it's Tarek here. Let me just add one final element of color. When you look at the quality of our customers, you got to look at all the metrics together. The churn is a measure of that quality, but also the bad debt is a measure of that quality. We had a very good performance on bad debt, which goes to show that the customer we're acquiring are not the bottom end of the market. We're not bottom fishing. Now people see value in our plans and see the superior network, and that's why they get to Sprint.

Ric H. Prentiss
Raymond James & Associates, Inc.

Q

Thanks for adding the extra color on the network densification plan. It was a crazy week obviously. Speaking of the network financing central vehicle, can you talk to us a little bit about will it be an interest expense that will be the effect on the Sprint side of that transaction? Or is it something operating related?

Tarek A. Robbiati
Chief Financial Officer

A

I would say that at this stage, we would deal with this transaction on balance sheet. It will not be an off-balance sheet transaction. And therefore it would not be accounted for by way of an operating expense. As was mentioned earlier on a question, it's really important that we retain ownership of the spectrum, and therefore when you think about it, if it is a lease, it is a capital lease and not going to be an operating lease.

Ric H. Prentiss
Raymond James & Associates, Inc.
Q

And as you think about the structure, it was going to be new assets, some of the existing radio access network and the spectrum, how would you split up those three components of what might be in the $3B to $5B, roughly just percentage wise?

Tarek A. Robbiati
Chief Financial Officer
A

It's too early to say at this stage. As you can imagine, it hinges on a number of factors, one of which is evaluation of all those components. But as we flagged, it is consisting of our existing RAN. Also we have to factor in the needs that the network team has to continue to densify the network and it factors in the cost of the new equipment and the construction of the new densified sites and finally the spectrum. And so you have an indication of the value of our spectrum on our balance sheet, but nonetheless, all of these figures have to be firmed up as we firm the structure up.

Ric H. Prentiss
Raymond James & Associates, Inc.
Q

Makes a lot of sense. And the final question, obviously there's a lot of questions on the structure. Is there anticipation that maybe some of the CapEx's new CapEx could be borne by that entity then as well instead of being CapEx on the Sprint side of things?

Tarek A. Robbiati
Chief Financial Officer
A

Well, certainly the purpose of raising money through that entity is to fund the deployment of the new network, and therefore the funds should cover the cost of the new CapEx that John and Günther require to densify the network.

Ric H. Prentiss
Raymond James & Associates, Inc.
Q

But you would take ownership of it at the Sprint site probably.

Tarek A. Robbiati
Chief Financial Officer
A

Correct.

Anthony Klarman
Deutsche Bank Securities, Inc.
Q

I have a few follow-up questions on earlier ones. I guess I wanted to sort of take the two data points on guidance and see if, just to make sure that we're not missing anything. You talk about adjusted EBITDA guidance of $ 9.5B to $10B. And I think earlier you were asked the question about free cash generation. And if you do $9.5B to $10B of adjusted EBITDA, and you were to get $3B to $5B in incremental liquidity from whatever the structure is of

NetworkCo that you'd be considering, are there any other puts and takes from a liquidity perspective? Because it would seem that in that scenario that you ought to be generating pretty significant FCF that you could use for debt reduction.

Tarek A. Robbiati
Chief Financial Officer

A

Yes, that's the intent. The intent is that with the cash flow that we would be generating from cost reductions on one side and our ability to raise capital through network LeaseCo on the other, we would be able to repay all the maturities that fall due during FY 2016. So what comes in the picture here, it's really important to understand, is the fact that we have to realize the cost reductions. Cost reductions are the top priority of the company. Everyone is focused on those. Now the timing of the cost reductions and the cost it takes to achieve those cost reductions have also to be taken into account as you try to establish a FCF figure.

We did say that we will realize $2B in run rate savings. We also pointed I think in my speech that we would be spending $1B to achieve that run rate of $2B of cost savings. The timing becomes a point that is really important when you establish that FCF equation, and we want to make sure that we raise the capital through network LeaseCo in time to be able to fund our plans and the cost it takes to achieve those cost reductions.

R. Marcelo Claure
President, Chief Executive Officer & Director

CLOSING REMARKS

- We have set high expectations for the future of Sprint, and I realize we still have plenty of work to do to reach our goals
- However, I could not be more excited as we have so much momentum across the business going into Q4. Our revenue trends are stable with near-term visibility to growth
- I think we're off to a great start to substantially reduce our operating expenses
- We're growing in postpaid phones again
- We have just put up three lowest churn quarters in the company's history and our network is absolutely the best it has ever been