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Sprint Corp. (S)

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CORPORATE PARTICIPANTS

Jud Henry
Senior Vice President of Corporate Finance and Treasurer, Sprint Corp.

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

Andrew Mark Davies
Chief Financial Officer, Sprint Corp.

OTHER PARTICIPANTS

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Brett Feldman
Analyst, Goldman Sachs & Co. LLC

Michael I. Rollins
Analyst, Citigroup Global Markets, Inc.

Landon Park
Analyst, Morgan Stanley & Co. LLC

Jonathan Chaplin
Analyst, New Street Research LLP (US)

Jeffrey Thomas Kvaal
Analyst, Nomura Instinet LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for standing by. Welcome to the Sprint Fiscal Fourth Quarter 2018 Conference Call. During today's conference call, all participants will be in a listen-only mode. Following their opening remarks, the conference will be open for questions.

I would now like to turn the call over to Mr. Jud Henry, Senior Vice President of Corporate Finance and Treasurer. Please go ahead, sir.

Jud Henry

Senior Vice President of Corporate Finance and Treasurer, Sprint Corp.

Welcome to Sprint's Fourth Quarter and Full Year Fiscal 2018 Conference Call. Joining me on the call today are Sprint's President and CEO, Michel Combes, our CFO, Andrew Davies, and our CTO, Dr. John Saw.

Before we get underway, let me remind you that our release, quarterly investor update and presentation slides that accompany this call are all available on the Sprint Investor Relations website, at www.sprint.com/investors. Slide two is our Cautionary Statement. I want to point out that in our remarks this afternoon, we will be discussing forward-looking information which involves a number of risks and uncertainties that may cause actual results to differ materially from our forward-looking statements. We provide a comprehensive list of Risk Factors in our SEC filings, which I encourage you to review.

Throughout our call, we will refer to several non-GAAP metrics, as shown on slide three. Reconciliations of our non-GAAP measures to the appropriate GAAP measures for the quarter can be found on our Investor Relations website. Like last quarter, we have included reconciliations and qualitative disclosures in the tables that accompany our release and investor update to provide additional clarity regarding the adoption of the new revenue recognition standard on our quarterly results. For the remainder of this call, we will discuss results excluding the impact of the accounting change to provide clearer comparability without prior periods, unless otherwise noted.

Please note that starting in our first fiscal quarter of 2019, we plan to discontinue reporting average billings per user, or ABPU, and average billings per account, or ABPA, which were metrics developed to provide transparency during the transition from subsidy to device financing rate plans that are no longer relevant. We will instead focus on average revenue per account, consistent with our strategy to grow revenue at the account level.

I will now turn the call over to Michel to provide you an update on our results.

Michel Combes

Chief Executive Officer, President & Director, Sprint Corp.

Thank you, Jud. Our fiscal 2018 results, on slide four, demonstrate our focus on executing our strategy. Of course, we also continue working towards government approval of our merger with T-Mobile. First, we stabilized wireless service revenue year-over-year. We delivered adjusted EBITDA at the high-end of our fiscal year guidance. We delivered postpaid net additions for the fourth consecutive year, driven by growth in data devices. We continued our digital transformation, increasing our digital sales and the implementation of artificial intelligence.

In addition, we increased our network CapEx spend by 50% year-over-year and our network continued to improve, as we have more LTE coverage and faster download speeds year-over-year. In short, we delivered on our guidance for fiscal 2018, but many of the underlying financial challenges remain.

Turning to slide five. We continued to make good progress in our Nexgen Network deployment to provide customers a network built for Unlimited. First, we upgraded thousands of our existing macro sites to add LTE on 800 MHz, 1.9 GHz, or 2.5 GHz to sites that previously lacked those bands. We now have 2.5 GHz deployed on approximately 80% of our macro sites compared to less than 60% a year ago.

In addition, we've added 800 MHz to thousands of sites, primarily in the southwest markets, as we completed additional re-banding, which will provide additional coverage for our customers. In addition, we now have approximately 30,000 small cells on air compared to about 5,000 at this time last year. This ramp in small cell includes more than doubling the number of Massive MIMO sites on air year-over-year and the rollout of strand mounts, which are delivering improvements in coverage, capacity and time on LTE to improve the customer experience in specific locations.

Our Massive MIMO deployment continues to be a momentum, delivering improvements in LTE performance and providing the building blocks for our mobile 5G launch in the coming weeks. We now have approximately 1,500 Massive MIMO sites commercially on air in a few markets where we are seeing promising early results.

We are also preparing to commercially launch our mobile 5G network later this quarter in nine cities.

Our Massive MIMO radios are software upgradable to 5G and are, as you know, allowing us to utilize our spectrum for both LTE and 5G simultaneously while we enhance capacity even further with 5G and begin to support new 5G use cases. Commercial service is expected to launch starting in the next several weeks with Chicago, Atlanta, Dallas, and Kansas City among the first cities to offer commercial 5G service, with Houston, Los Angeles, New York City, Phoenix, and Washington D.C., also planned to launch by the end of June.

The total initial 5G coverage for Sprint across all nine cities is expected to be more than 1,000-square miles. We have also announced standards-based 5G devices from LG, HTC, and Samsung that will be available soon. The other carriers are not standing still, investing significantly more capital into both the LTE and 5G networks. In reference, we are making the best of the limited financial and low-band spectrum resources that we have.

Nevertheless, we are hopeful to complete our merger with T-Mobile, which will allow the combined company to have the breadth and the depth of spectrum to provide a truly consistent nationwide 5G experience. As a standalone company, we lack the scale to keep pace with the bigger carriers, AT&T and Verizon, in sustained capital investments. And without additional low-band spectrum, we will face challenges to provide customers with consistency of coverage comparable to that of the two big carriers.

Turning to slide six. We continued our Unlimited for All approach to deliver retail net additions for the second consecutive year. Our postpaid net additions were 710,000 in fiscal 2018 and 169,000 in the fiscal fourth quarter. This is a result of executing our strategy to grow our relationship with customers for data devices, such as tablets, watches and the successful launch of our Sprint Drive connected app product, which is partially offset by [ph] low season phones (8:20).

Total postpaid gross adds were up slightly year-over-year for both the full year and the fourth quarter, as we increased sales of data devices. Postpaid phone gross ads were down year-over-year, as Sprint was less promotional in our service plans compared to year ago, with approximately 30% fewer postpaid phone gross adds on discounted promotional service plans year-over-year. Meanwhile, competitor offers were more aggressive with retail device offers from AT&T and Verizon. We would expect postpaid phone gross phone adds to be slightly lower sequentially in the first quarter, given seasonality and continued competitive environments.

Postpaid phone churn was up year-over-year for both the full year and fourth quarter, as we had foreshadowed previously, as customers running off introductory promotions have been the primary driver of the year-over-year increase in churn. Postpaid phone churn is expected to remain up year-over-year in the first quarter of fiscal 2019, although we do expect improvement sequentially, due primarily to seasonality similar to last year.

We believe that the investments we are making in our network and customer experience may improve churn and help to lessen the perception gap that impacts gross adds today, but it takes time to shift perception and structural headwinds keep our churn higher than peers.

For Sprint to continue in a multi-year capital program for our Nexgen Network to improve LTE and prepare for 5G, it's important to be able to deliver service revenue growth and free cash flow all the time. In addition to selling additional data devices to customers, we are also executing our strategy to grow revenue from smartphones by providing customers the option to upgrade to our feature-rich Unlimited Plus and Unlimited Premium plans.

This [ph] higher loading on (10:41) feature-rich plans and the 30% reduction in discounted promotional lines, as I mentioned earlier, has delivered a more than 15% increase in postpaid phone monthly recurring charges on new account gross adds coming to Sprint in fiscal 2018 compared to last year. However, the loss of postpaid phone customers for the last three quarters and expected losses in the first quarter of fiscal 2019 will put pressure on postpaid service revenue in fiscal 2019.

We continue to believe that optimizing the balance of gross adds, churn and ARPU is expected to deliver better a financial outcome over the long-term. We have slowed the decline in our total net of postpaid accounts year-over-year while growing the number of lines per accounts. However, if AT&T and Verizon continue with the aggressive promotional activity we have recently seen, it may slow our path to reduce churn and drive new account gross adds away from Sprint which will make it difficult to maintain wireless service revenue in fiscal 2019.

In addition, our business segment continued to grow in fiscal 2018 with total gross adds up year-over-year and lower churn, delivering postpaid net additions from businesses. While we have seen some success in the business space, it has been on a relatively small scale relative to the dominance that AT&T and Verizon have today. That is why we're excited about the opportunity to finally have the scale to truly disrupt the business segment through our merger with T-Mobile.

Turning to prepaid, we see pressures throughout the fiscal year, including in the fourth quarter, from industry decisions continuing to shift to postpaid and aggressive offers from bigger competitors in the market. Boost delivered net adds of nearly 600,000 before migrations to postpaid in fiscal 2018. However, this strength in Boost was offset by losses from our other prepaid brands and migrations to postpaid.

Turning to slide seven. We continued to drive the digital transformation of our company, as I have highlighted in recent quarters. Because we lack the scale of the biggest wireless carriers, we must be more innovative by leveraging digital capabilities and employing advanced analytics, artificial intelligence and intelligent automation in our operations to further optimize our cost structure.

Our digital transformation is based on three main pillars: increase digital revenue through improvements in gross adds and upgrades for digital channels, provide intelligent customer experience by leveraging AI, analytics and data-driven decisions, and improve digital engagement

with our in-house digital marketing agency and enhanced app functions.

From a digital perspective, postpaid gross adds in digital channels increased approximately 60% year-over-year in both the fiscal fourth quarter and for the full fiscal year. Additionally, we exited the year with nearly 20% of postpaid upgrades occurring in digital channels.

Likewise, we are ramping our rollouts of a cutting-edge intelligent customer experience, leveraging AI and analytics. We are seeing growth in digital customer engagements from chats, and on top of that, we have ramped to 30% of chats being handled by virtual agents and the experience continues to show improving SPS or customer satisfaction. This is complementary to our overall customer experience, as the automation of the simple customer requests allows our live agents to spend more time helping customers resolve their more complex issues.

Lastly, our in-house digital marketing agency is delivering solid early results compared to our previously-outsourced model, with click-through rates up year-over-year while cost-per-click is down significantly. The digital transformation and data-driven culture is expected to contribute to the evolution of our customer experience and potential cost reductions in the future.

I will now turn the call over to Andrew to take you through our financial results.

Andrew Mark Davies

Chief Financial Officer, Sprint Corp.

Thank you, Michel. As Jud mentioned in his opening remarks and consistent with our practice for the last three quarters, I'm going to discuss results based on prior revenue recognition standards for better comparability, unless otherwise noted. Let's begin with revenue on slide eight. Consolidated net operating revenues were $33.1 billion for fiscal 2018 and $8.3 billion for the fourth quarter, an increase of $659 million and $216 million year-over-year, respectively. While the service revenue of $22.5 billion stabilized in fiscal 2018 as it was essentially flat year-over-year, mostly due to growth in our retail customer base and a slowing decline in postpaid ARPU.

For the fourth quarter, wireless service revenue of $5.6 billion was up slightly from the prior year. However, as Michel mentioned earlier, the pressure we are currently seeing in retail customer growth will make it difficult to continue this trend of year-over-year growth for wireless service revenues. While we have now reported an entire year under the new revenue standard, I would like to remind you that the impacts of this change will extend in the fiscal 2019, even when comparing two results under the new standard.

For example, the negative impact of prepaid service revenue will actually be bigger in fiscal 2019 than it was in 2018. As a result of this accounting impact and other operational trends, reported wireless service revenue will likely be down approximately $150 million to $200 million year-over-year in the fiscal first quarter of 2019, with the accounting impact being the primary driver.

Postpaid ARPU of $44.54 for the year declined 3% year-over-year, the smallest decline in five years, and was impacted by our strategy of driving more data devices which generate additional service revenue for the company, but do put some pressure on ARPU due to generally having lower monthly charges.

For the fourth quarter, postpaid ARPU of $43.99 was down 1% year-over-year, primarily due to the same factors that drove the full-year decline. Postpaid phone ARPU in the fourth quarter was essentially flat year-over-year, as base customers rolling off promotions and other pricing actions were offset by the impact of other promotional discounts. Prepaid service revenue for the full year and fourth quarter of $4 billion and $1 billion, respectively, were both up slightly year-over-year as our prepaid ARPU remained stable and we saw customer growth within our Boost brand.

Let's now turn to costs and EBITDA on slide nine. We continued to execute on our cost transformation in fiscal 2018 and achieved both our gross and net cost reduction targets for the year. Excluding the impact of the new revenue recognition standard and merger-related costs that were included within SG&A expenses, we delivered approximately $1.2 billion of combined year-over-year growth reductions in cost of services and SG&A in fiscal 2018 and net reductions of approximately $330 million after reinvestment in network and other operational initiatives. While we continue to look for opportunities to improve operational and cost efficiencies in fiscal 2019, these improvements are expected to be largely offset by incremental costs associated with network and customer experience initiatives.

Cost of services of $6.7 billion for the year were down approximately $60 million year-over-year as lower wireline network expenses were partially offset by incremental expenses associated with our increased network investments. For the quarter, cost of services of $1.7 billion were flat year-over-year, but the incremental OpEx associated with our increased investments and our decision to expand LTE coverage through roaming agreements will likely lead to a year-over-year increase in both the fiscal first quarter and full year of 2019.

SG&A expenses were $8.2 billion for the full year and $2.1 billion for the quarter. When adjusting for merger costs, which are not included in adjusted EBITDA, SG&A was down year-over-year by approximately $270 million on a full-year basis and approximately $40 million in the fourth quarter. While more efficient marketing spend was a driver of both declines, the quarterly decline was additionally impacted by lower selling expenses, but also higher bad debt expenses associated with an increase in installment billing sales.

As we move into fiscal first quarter of 2019, we will be facing a year-over-year headwind on SG&A expenses from the new revenue recognition standards impact on the optimization of commission expenses. Adjusted EBITDA of $11.9 billion for fiscal 2018 came in toward the high-end of our guidance and improved by $846 million year-over-year, while for the fourth quarter adjusted EBITDA was $3 billion, an improvement of $183 million year-over-year.

Given the aforementioned expectations in terms of revenue and costs for the first quarter of fiscal 2019, we expect adjusted EBITDA to be $400 million to $500 million lower year-over-year for fiscal first quarter, with the non-cash impacts to revenue and commission expenses and the new revenue standard being factors.

Turning to slide 10. Operating loss was $460 million for the year compared to operating income of $2.7 billion in fiscal 2017. This includes a preliminary $2 billion non-cash charge as part of our annual impairment testing. Excluding the dilutive impact of this non-cash impairment and a further approximately $350 million of merger-related costs in fiscal 2018 and the beneficial impact of approximately $800 million from spectrum gains and litigation settlements in fiscal 2017, operating income would've been relatively flat year-over-year.

For the fourth quarter, operating loss of $1.9 billion included several non-recurring items, with the most material item being the preliminary $2 billion non-cash impairment charge that I've just mentioned as well as $304 million related to a loss on asset dispositions and $130 million related to merger costs.

Regarding the impairment, it was part of our annual evaluation of long-lived and indefinite-lived assets under U.S. GAAP. While we delivered solid financials again in fiscal 2018, our hurdle rate has increased as the book value of our equity has grown by about $9 billion in the last six quarters, due primarily to non-cash items, including tax reform and the adoption of the new revenue standard. This non-cash accounting charge is not expected to impact liquidity, cash flows, compliance with the debt covenants, or any future operations.

Net loss of $2.6 billion in fiscal 2018 compared to net income of $7.4 billion in the prior year. This includes the preliminary $2 billion impact from non-cash impairment charge this year and the $7.1 billion non-cash benefit from tax reform included in last year's results. For the fourth quarter, the net loss and $2.3 billion compared to net income of $69 million in the prior-year quarter and the current quarter included a preliminary $2 billion non-cash impairment charge that I've just discussed.

Turning to slide 11, on CapEx and free cash flow. Network cash capital expenditures for the full year and fourth quarter are $5 billion and $1.1 billion, respectively, with both up 50% year-over-year as we continued to execute on our Nexgen Network plan. With our continued deployment of Massive MIMO and the commercial launch of mobile 5G coming soon, we do not expect a material changes to our current level of capital spending in the near term, with cash CapEx in fiscal first quarter expected to be similar to the fiscal third quarter of 2018.

Fiscal year 2018 net cash provided by operating activities of $10.4 billion improved by $367 million year-over-year and our fourth quarter result of $2.8 billion improved by $194 million year-over-year. Adjusted free cash flow of negative $914 million was within our guidance range and declined year-over-year as a result of higher network investments.

For the fourth quarter, adjusted free cash flow of negative $539 million was approximately $300 million lower than the year-ago period due to higher network CapEx and lower net proceeds of financings related to devices and receivables. We continue to have an adequate liquidity position, with approximately $10 billion of general-purpose availability, including $7 billion of cash, cash equivalents and short-term investments.

In summary, I'm pleased with the team's ability to deliver our fiscal 2018 financial plan. While we have given some color today on our expectations going forward, we are not going to provide any full-year guidance for fiscal 2019 at this time, as we are in the late stages of our T-Mobile merger process. Thank you.

And with that, I will now turn the call back to Jud to begin the Q&A.

Jud Henry

Senior Vice President of Corporate Finance and Treasurer, Sprint Corp.

Thanks, Andrew. In just a moment, we will begin the Q&A. May, please inform our participants how to queue up for the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: Absolutely. [Operator Instructions] We'll pause just a moment to compile the Q&A roster. Your first question comes from the line of Philip Cusick of JPMorgan Securities Corporation. Your line is now open.

Philip A. Cusick

Analyst, JPMorgan Securities LLC

Q

Hi, guys. Thanks. You've told regulators that your phone base has been buoyed by free add-a-line programs for years. How do you track what's a legitimate user versus not and how many of those are low or no-usage devices? And how has that trended over the last few years? And what's the pace of them coming off of their free-line period over the next year? Thank you.

Michel Combes

Chief Executive Officer, President & Director, Sprint Corp.

A

Thank you, Philip, for the question, which, first, will allow me to clarify some misunderstandings around our, quote, unquote, free lines. Free lines, in this context, are referencing the way we market to customers, but doesn't necessarily mean these customers are paying $0 for their service.

If I take an example, our lines three to five free promotions are only free when customers sign up for our Unlimited Basic Plan and are on Auto Pay. And as you know as well, we've actually good success with customers taking our Unlimited Plus and Premium Plans, where customers still get an introductory discount, but they still pay something for the service. So that's just to be clear on what, let's say, is in it when people are speaking about free lines.

While we're being less promotional this year, we will not be able to completely remove these promotions due to AT&T and Verizon promotional activity and until we see more significant improvement in the network and customer experience. You probably remember that I mentioned different occasions in the previous quarters that the intent was to be able on [indiscernible] (29:06) to remove those promotions. But for the time being, we have been able to reduce the intensity of those promotions, but not completely to remove them for the reasons that I have just highlighted.

While we have seen some incline, I guess I gave let's say in my introductory remarks, let's say a flavor of the reduction by saying that we had, reduced more or less, the number of lines by 30%.

While we have seen some incremental term pressure, the attitudes stay after the promotional period and so it has helped our wireless service revenue trends. So, as you know, let's say, those promotions raise our churn, but nevertheless, up to now have proven to be beneficial from a revenue perspective. Once again, that's not something which should remain for the long run, but, we have delivered what we were supposed to deliver to start to reduce this intensity and will continue.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Maybe if I can ask a different issue, same subject. You've mentioned these lines are down 30%. How should we think about the pacing of them coming off of that discounted contract over the next year? Is there a slowing from here or is there any sort of bubble coming?

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

I'm not sure I understood your question. Can you just repeat it?

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

I was just going to say, how should we think about the pace of those promotions coming off of their promotion period over the next year? Are we in the slowing-down period of those customers coming off of those aggressive promotions? You said that the number of lines in that promotion are down 30% already.

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

So, you can expect that [indiscernible] (31:12) all our promotions are for the next coming quarters, so they will churn out of the promotion in the next coming quarters. As we are entering less customers in those promotions, we'll have less customers exiting from those promotions going forward, so which means that you should expect an improvement of our churn moving forward. That's what we are looking for.

The only point is that we have to pace it in a proper manner to make sure that we continue to be attractive in the marketplace until we have improved some of our basic issues, which are network-related and customer-experience related. So that's kind of a delicate balance in between our ability to improve our basics and our ability then to remove progressively these aggressive promotions, and that's what we're managing carefully.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: Our next question comes from the line of Matthew Niknam of Deutsche Bank. Your line is open.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys. Thank you for taking the questions. Just two, if I could. One may be a follow up a little bit on the last question, Competitively, any updates you can share in terms of what you saw during the quarter, how that's trended into fiscal 1Q, if things have gotten worse at all?

And then secondly, on the adjusted EBITDA. I know there wasn't annual guidance provided, but it sounds like the $400 million to $500 million in headwinds that you're expecting in fiscal 1Q, is that a good proxy for costs or year-on-year headwinds that can recur into the following quarters? And I'm trying to get a sense of if your service rate and revenue stay flattish and you've got this $400 million to $500 million headwind each quarter, is that a good way to think about it to say EBITDA is going to be down $1.5 billion to $2 billion next year? Thanks.

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

So I will let Andrew take the second question having in mind that, as we have said, we are not giving guidance for the full year, so we just have given you a few indications in order for you to be able to forecast first quarter and we'll come back in due course depending on what will be the outcome of the situation in which we are.

On your first question, competitive environment. I guess we have seen all of the players, regardless of their size and current position, making really aggressive offers to go after new customers and maintain their existing customer base. That's what we have seen in Q4 and that's what we continue to see in Q1.

So, we continue to see very aggressive device promotions from Verizon, AT&T. And their recent promotions have had much less restrictions than in the past. For example, no DirecTV requirements or no trade-in requirements. So, which means that those promotions are much more aggressive than what we have seen in the past.

AT&T was particularly aggressive last quarter and is continuing to be so into this quarter as they ran a BOGO with no restrictions and increased quite significantly their advertising spend. And also, the two large cable companies continue also to take share of postpaid gross adds.

So all-in-all, a very competitive environment within which we are trying to remove some of our own promotions, as I have just explained, in order to be in a better position moving forward, as I have alluded to. By removing 30% of those, between quotes, free lines, we've been able also to grow our gross adds MRC, which is in the middle run something which is positive for the company. But once again, we have to address all those criteria, meaning loading gross adds, loading MRC as we are moving forward in order to find the right balance. And that's what we are moving through right now.

Andrew Mark Davies
Chief Financial Officer, Sprint Corp.

A

Okay. Thank you, Michel. And thanks for the question, Matthew. We consciously avoided giving any forward, strong guidance on a full-year basis here. We just think in the context of things that it's appropriate to talk about Q1 and give some more quality color around that.

So, yeah, we expect the adjusted EBITDA to be somewhere in the region of $400 million to $500 million and down year-over-year for the quarter. Quite a bit of that being non-cash, driven by the impact of the 606 Revenue Recognition Standard, which affects wireless service revenues, to start off with, which would be likely down $150 million to $200 million year on year, with a good two-thirds of that being just the accounting impact. The other accounting impact is in the gradual buildup of amortization of commission expenses over time, particularly with regards to our prepaid business.

And then lastly, there are some conscious headwinds that we've created through network investment, and that's both the impact of having a larger footprint year on-year consistent with our Nexgen Network program and also some conscious decisions that we've taken on an interim basis to expand our LTE coverage through larger roaming agreements with a couple of larger competitors that we have. So that's kind of where we are for Q1. And I'm not going to say that you should just lineally extrapolate those headwinds over the next four quarters; that would be inappropriate for me to say so.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Your next question comes from line of Brett Feldman of Goldman Sachs & Co. Corporation. Your line is open.

Brett Feldman
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thanks for taking the question. And just two around free cash flow. First, it looked like there was a fairly significant use of cash related to repayment of proceeds from device financings in the quarter. I'm wondering if you can give us some context as to how that line item is going to trend going forward. Is it going to continue to be a use of cash as you pay down existing facilities? Or is it just going to oscillate quarter to quarter?

And then I know you're not introducing any new guidance for this fiscal year, but you had previously said you expected cash flow to be breakeven. It doesn't sound like your view on capital spending has changed from where it had been before. Is there anything else in terms of major free cash flow drivers that might be different from what they were when you originally anticipated you could get to a breakeven number in this fiscal year? Thank you.

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

Andrew?

Andrew Mark Davies
Chief Financial Officer, Sprint Corp.

A

Yes, thank you, Brett. I understand the questions. So, first of all on the use of cash in the quarter and what we think about that going forward, so to your point, we did have quite a sizable net repayment of receivables facilities in the quarter.

I think within our $10 billion of total liquidity that we had available at the end of 4Q, roughly $750 million of that is on receivables facilities. And going forward, it's not about focusing on an adjusted free cash flow metric, per se; it's about just managing the overall liquidity position that we have as a company going forward. And with $10 billion, we've got good liquidity right now, but it's something that we're going to have to keep an eye on.

With regards to other large forms of cash flow movement for fiscal 2019, we see, to your question, we see no other major deviations or changes from what we've previously being assuming in our guidance. So, yes, we continue with that highest level of CapEx for the next 12 months or so, roughly $5 billion on an annual basis, but there are no other major changes that I expect in our cash flow projections.

Brett Feldman
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Your next question comes from the line of Michael Rollins of Citigroup Investment Research. Your line is open.

Michael I. Rollins
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking the question. Curious if you could delve a little bit more into the strategy on device rentals and how you look at the rental of devices versus just selling them outright and what kind of impact that would have on the operations.

And if I could just add another question to that topic. It looks like, if you take the P&L data, it looks like the net margin if you take the equipment rental revenue less the cost and depreciation, it looks like it's gotten significantly more positive year-over-year and quarter-over-quarter. Is this just a more profitable business in terms of margin contribution when you look at it all-in, or are there some temporary factors at work causing the change in your latest fiscal quarter? Thank you.

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

Thank you, Michael. I will take the first part of the question and I will turn it to Andrew for the second part. A lot has changed in the marketplace since we launched our leasing program in 2014. We were, as you remember, [indiscernible] (41:38) in that space. As customers are now keeping their device longer, we've been trialing whether it makes sense to continue our leasing program.

Regardless, we plan to provide whatever financing options make the most sense for our customers, whether that is financing, different ways to do that, whether it's leasing or OD or BYOD. So, we trial different offers all the time and we'll let you know if and when we make any changes in our go-to-market strategy. But it's fair that we need to assess the market from a permanent basis in order make sure that, A, we are relevant for the customers and, B, we optimize the P&L for the company.

So on that, maybe, Andrew, you can answer on this P&L back to the strategy.

Andrew Mark Davies
Chief Financial Officer, Sprint Corp.

A

Yeah, so, Mike, on the P&L aspect, I think what you might be noticing it is a little bit of a timing disconnect in the sense that – so it's the handset equivalent of a Mercedes-Benz versus a Chevrolet, right, in that we establish residual values for devices as we go along. And we've got good history and data on that because obviously we run the reverse logistics processes and the auction processes as well.

So, we depreciate devices down to residual values over the first 18 months of a customer contract and thereafter. If a customer keeps the device, we depreciate them to $0. So basically, as more expensive devices have come to market in another 6 months to 12 months, what you end up having is a bigger mix of devices which have residual values that are a higher percentage of original SRP than we had previously.

And so that, then, manifests itself in a slightly lower depreciation profile over time. But then consequently when the devices come back to us through the reverse cycle, we end up making less margin at auctions as well. So, it all squares out of the end of the day, but you do introduce a bit of a timing issue when you have a heavy mix of relatively high SRP devices.

Operator: Your next question comes from line of Simon Flannery of Morgan Stanley. Your line is open.

Landon Park
Analyst, Morgan Stanley & Co. LLC
Q

Thank you. This is Landon Park on for Simon. I was just wondering if you could run through your expectations for the network build after the 2.5 GHz is fully deployed. And maybe can you also run through expected second-half launches on the 5G side and how you're approaching additional markets?

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.
A

So, maybe, Jud, you can update.

Jud Henry
Senior Vice President of Corporate Finance and Treasurer, Sprint Corp.
A

Yes, as you know, our 2.5 GHz build has achieved 80% of our total sites compared to just 60% a year ago. I think the path forward is to continue to invest in 2.5 GHz, but in a different form factor. Massive MIMO technology has shown to perform really well in the field so far. And I can see us continuing to invest in Massive MIMO technology, rolling out more and more 2.5 GHz.

As I mentioned in the past, with massive MIMO and with the spectrum that we have in 2.5 GHz, we can simultaneously supply both LTE and 5G. So, it's like kill two birds with one stone. So, I can see us moving forward to continue to invest in Massive MIMO.

We have not announced any other 5G markets beyond the nine metro areas that we're covering in the nine markets. And we don't expect to announce any until at a later date. In the meantime, the team is busy getting ready to roll out our first markets in the next few weeks.

Landon Park
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thank you.

Operator: Your next question comes from the line of Jonathan Chaplin of New Street. Your line is open.

Jonathan Chaplin
Analyst, New Street Research LLP (US)
Q

Thanks. Michele, just a small follow-up question for you. With 30% lower customers on free service subscriptions, why wouldn't we have seen a much bigger increase in ARPU year-over-year?

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.
A

So what I have said and I guess that we have seen quite a significant uplift of [indiscernible] (47:14) our gross adds, meaning that we have added 30% percent reduction in the discounted promotional line, as I have already mentioned. And we had a 15% increase in postpaid monthly recurring charge on new account gross adds coming to Sprint. So, we have the benefit of it for the new customers moving to Sprint. And, of course, we have the [indiscernible] (47:44).

And so, I don't know if you're referencing [indiscernible] (47:53) or whether you're referencing the growth of ARPU. So that's the way that works. And I tried to – the postpaid phone app is relatively flat sequentially and year-over-year because this is driven by big customers rolling off promotions and increasing their monthly spend with us along with other pricing actions which offset the impact of other promotional discounts that we have continued to give on service but also on handsets.

Operator: Your next question comes from the line of Jeffrey Kvaal of Nomura Instinet. Your line is open.

Jeffrey Thomas Kvaal
Analyst, Nomura Instinet LLC

Q

Yes, thank you very much. I wanted ask a tricky question in a polite way, I like to think. The headlines that we've gotten out of the regulator-ish stories have suggested some concern on the part of Sprint talking about a sustainable path. And I guess I was hoping that you would either put that into context for us or help us digest that in a way that perhaps the news articles haven't.

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

That's not a tricky question. I would say it's even a fair question, and so thanks for writing. I think as you are asking for context, the recent filing was intended to give the regulators additional insight into the challenges that we are facing in our ability to be an effective competitor absent the transaction. It's fair to say that most of you are very familiar with the challenges that we are facing, which is not always the case of everyone. So that's why we wanted to give this fair view.

The finding is fully consistent with the information which has been provided in our prior public filings, including the specific reasons for and benefits of the proposed merger. So we just wanted to make sure the regulators clearly understood what both the competitive environment and the pace of 5G deployment would look like with and without the merger as we have to compare those two situations, what would happen if the merger takes place or if the merger doesn't take place.

And while Sprint has made a lot of progress improving its network and financials over the last few years, as you have seen once again in our report, and also in changing the course of the business with the different questions that you have raised during this session, we still lack low-band spectrum, we still lack scale and we still lack financial resources related to a change in Verizon. So that's fact, and that's just what we wanted to update the regulators with.

Jeffrey Thomas Kvaal
Analyst, Nomura Instinet LLC

Q

Okay, Michel. That's fair. If I may follow-up for a second. There is the possibility that at some point over the next weeks or months that we wake up in the morning and the likelihood of a T-Mobile merger comes down quite a bit. Given these concerns and comments that you have just expressed to us, what should we be then making of the prospects for the company looking out a few years from that?

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

A

So, first of all, I would like to say that we remain optimistic that the government will see a compelling argument in support of a merger. So that's the first comment I would like to make because we believe that's a benefit, really huge. If the merger doesn't go through, we expect to continue to make improvements to the business, including our Nexgen Network deployment, as has been mentioned by Jud. Also, the digital transformation, which has been referred to by myself and Andrew, which will allow us to continue to reduce our [indiscernible] (52:17). And we will have to reposition the company, reposition the company in how we play and which battlefield will be ours.

While Sprint has made a lot of progress improving network and financials, as I have just mentioned, we still lack, let's say, we still have offsetting challenges that I've mentioned, which means that we will have to reduce, of course, our promotional activity in the market, we'll have to narrow our geographic focus. So at the end of the day, that means that we will be less of a nationwide competitor to AT&T and Verizon. So [ph] that's site based, (53:03) and we'll have to reposition the company that way.

Jud Henry
Senior Vice President of Corporate Finance and Treasurer, Sprint Corp.

Thanks, Jeff. That's all the time we have for questions today. But before we end the call, I'd like to turn it back to Michel for some closing comments. If you have any additional questions following the call, please contact the Spring Investor Relations team.

Michel?

Michel Combes
Chief Executive Officer, President & Director, Sprint Corp.

Thank you, Jud. So, I just wanted to thank everyone for joining us today and for supporting Sprint. While our underlying formidable challenges remain, as I just explained, our fiscal 2018 results demonstrate continued execution of our plan to balance capital growth and profitability while improving network performance in the near term. So, I'm proud of what has been achieved.

We continue to deliver retail net adds for the second consecutive year. We improved profitability with our adjusted EBITDA at the high end of our guidance. In addition, we are executing our Nexgen Network deployment to deliver a network ideal for Unlimited while building the foundation for our mobile 5G network that will launch commercially in nine cities in the coming weeks. We continue to explore ways to enhance our value proposition and continue to transform our cost structure and customer experience with digital, Artificial Intelligence, advanced analytics and automation.

Thank you and have a great end of day.

Operator: Ladies and gentlemen, this concludes today's conference call. You may now disconnect.