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Sprint Corp. (S)

Q1 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for standing by. Welcome to the Sprint Fiscal First Quarter 2016 Conference Call. During today's conference call, all participants will be in a listen-only mode. Following the opening remarks, the conference will be opened for questions.

I'll now turn the conference over to Mr. Jud Henry, Vice President of Investor Relations. Please go ahead, sir.

Jud Henry

Head-Investor Relations

Good morning, and welcome to Sprint's quarterly results conference call. Joining me on the call today are Sprint's President and CEO, Marcelo Claire; and our CFO, Tarek Robbiati. Before we get under way, 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 2 is our cautionary statement. I want to point out that in our remarks this morning, we will be addressing forward-looking information that 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'll refer to several non-GAAP metrics as shown on Slide 3. Reconciliations of our non-GAAP measures to the appropriate GAAP measures for the quarter can be found on our Investor Relations

website. In addition, I would like to mention that all references to customers or connections in our remarks represent results or expectations for the Sprint platform unless otherwise indicated.

Let's move on to earnings for our first fiscal quarter of 2016 on Slide 4. Sprint's net loss for the quarter was \$302 million or \$0.08 per share, compared to a net loss of \$20 million or \$0.01 per share in the year ago period.

This quarter included non-recurring contract termination charges of \$113 million, primarily related to the termination of our wholesale agreement with nTelos.

Lastly, although Clearwire's financial results are now consolidated within Sprint and included in today's presentation, its standalone quarterly financial results will be available on our website in the next several weeks as required by its debt covenants.

I will now turn the call over to Marcelo to provide you an update on our transformation.

R. Marcelo Claire

President, Chief Executive Officer & Director

Thank you, Jud, and good morning, everyone. We continued to execute on our turn-around plan and delivered a solid start to the fiscal year with a strong result in this first quarter. We had the highest postpaid phone net additions for a fiscal quarter in the last nine years, including Nextel migration. This was driven by our best ever postpaid phone churn in the company's 20-year history in wireless and continued growth in postpaid phone gross adds. As a result, Sprint was postpaid net port positive against all three national carriers this quarter for the first time in over five years.

At the same time, we grew wireless operating revenue year-over-year while aggressively reducing the cash operating expenses of the business to improve our operating cash flows. We now have nearly \$11 billion of liquidity after successfully executing financing transactions in this quarter. In addition, we have rolled out our LTE Plus service in more markets, bringing the total to 237 markets. And our 2.5GHz spectrum now carries the highest percentage of our LTE traffic, which is providing a much better customer experience.

Turning to Slide 6, Sprint continued to build momentum in customer growth in the first quarter of 2016, with 377,000 total net additions in the quarter, with a particular focus on postpaid phones, which had the highest profit contribution to our business.

Postpaid net additions for the quarter were 180,000, and as I mentioned a moment ago, we were postpaid net port positive against every national carrier this quarter for the first time in over five years. In other words, more Verizon customers switched to Sprint than a Sprint customer left for Verizon and this was the case with AT&T and T-Mobile as well. As I mentioned, this growth was almost entirely from the highest profit contribution category of our business as our postpaid phone net additions of 173,000 for the quarter improved by nearly 200,000 year-over-year, and were the highest for a first quarter in nine years, excluding the Nextel migrations in prior years.

This marks the fourth consecutive quarter of growth in our postpaid phone base, and we grew postpaid phone gross adds by 10% year-over-year. Furthermore, we delivered over 400,000 more postpaid phone net additions than AT&T in this quarter.

In addition, postpaid phone churn was the lowest in Sprint history at 1.39%, and improved by 10 basis points from last year's previous record low. This makes the sixth consecutive quarter of year-over-year improvement in postpaid phone churn, and it speaks to the continued improvement in our network and consumer value

proposition. Total postpaid churn was flat year-over-year as the roll off of tablet promotions from two years ago offset the improvement in phone churn.

Prepaid net losses in the quarter were 331,000, and improved compared to net losses of 366,000 a year ago. This is driven by continued competitive intensity in the prepaid space as well as the impacts of repositioning some of our prepaid brands this year. Prepaid remains an important part of our business, and I'm confident that we can return to growth in the future with a renewed strategy, refreshed value proposition, and the leadership changes we just announced in our prepaid group.

Lastly, our wholesale and affiliate business continued to grow for the 12 consecutive quarter with net addition of 528,000.

Now, let me update you on our progress on the network on Slide 7. Our network is performing at best ever levels and we're delivering on our goal of unlocking the value of our spectrum holdings by densifying and optimizing our network to provide U.S. consumers the best experience.

Our LTE Plus Network is now in 237 markets across the country, as we rolled out carrier aggregation in 33 additional markets since last quarter. Customers across the country tell me that the reliability and data speed are the most important things to them, and that is where we're improving the most. It is great to see so many third parties showing improvement in Sprint's network month-over-month and year-over-year.

Nielsen Mobile Performance data shows that Sprint continues to deliver the fastest LTE download speeds as compared to Verizon, AT&T and T-Mobile. Based on how real customers are actually experiencing the network by using crowd-sourced data that is always being collected, uninterrupted in the background.

Drive test from Nielsen showed that Sprint's network reliability has improved dramatically in the last two years and is now within less than 1% of both AT&T and Verizon. You can also see the improved quality of our network in the results from independent mobile analytics firm, RootMetrics in the first half of 2016 compared to prior testing periods, including a 75% increase in first-place awards for network reliability.

Most recently, PC Magazine, which has historically been a tough critic of the Sprint network released its fastest mobile network reports testing the speeds of all four carriers in the main 30 cities and this year's story is that the Sprint is finally back. PC Magazine noted that we showed a spectacular big download speeds nationwide and we beat both T-Mobile and AT&T in average download speeds, while we beat Verizon in reliability.

Now it's 2016, and benchmark tests by independent third parties show that all networks are good, and they're all very competitive. However, we remain focused on our goal of achieving network parity or superiority, and we're very excited about what our densification and optimization strategy can deliver in the future by focusing on improving the cost and performance of the network as you can see on Slide 8.

This includes bringing LTE Plus to even more markets and further unlocking the power of our deep spectrum position. Sprint has more spectrum deployed on LTE per consumer than any other carrier today. And no other company has the spectrum to unlock the power of carrier aggregation like Sprint does. We're already rolling out devices in the market that supports three channel carrier aggregation that are expected to deliver big speeds in excess of 200 megabits per second when we were allowed three channel carrier aggregation in the network expected as early as – early 2017.

Our customer experience has improved as our 2.5GHz footprint has grown over the last two years. With 2.5GHz spectrum band now carrying more LTE traffic than the 800MHz and 1.9GHz band. We plan to continue to add to the 5GHz to our LTE footprint to further unlock the power of our spectrum asset.

Everything we do is focused on putting our spectrum assets to work for our customers at the lowest possible cost. We're leveraging all forms of site structures including existing public infrastructure in order to densify our network and provide more capacity than any other wireless carrier in the U.S. We're expanding the many tools in the tool box today for maximizing network performance, as well as efficiency of capital and the operating cost. With these tools, the cost to build and operate these densification site are expected to be materially less than our macro site built in the past.

Our densification and optimization plan is also building the foundation for 5G as all carriers more densify their networks to leverage the high frequency spectrum bands planned for 5G. In fact, we recently provided live over-the-air demonstrations of our 5G capabilities using millimetric band radius to deliver 4K streaming of soccer content and virtual reality exhibits at two stadiums hosting the Copa America tournament in June.

Moving to Slide 9, our improved network and the compelling value of our offer is gaining significant traction with U.S. consumers. You can see this reflected in the year-over-year improvement in both our postpaid phone gross adds and our postpaid phone churn. In addition, you can see our continued discipline to grow the postpaid phone average billings per user year-over-year from our portfolio of offers.

I have discussed previously how perception has lagged reality on both accounts, and we're starting to break through with one of the most successful marketing campaigns in Sprint's history. As I mentioned earlier, all networks are good today, so it was time to make that point clear.

With the help of Paul Marcarelli, the actor who used to ask if you could hear me now for Verizon, will launch an advertising campaign to highlight the fact that networks today aren't that different so customers shouldn't have to pay more. The campaign has been one of the most successful in company's history with over 1 billion impressions already, as the ad has been viewed over 8 million times on YouTube, with nearly 300 million impressions on social media and close to 100 million impressions on broadcast media.

We expect future growth to come primarily from better execution and accountability, with greater efficiency in our marketing spend and establishing a regional accountability model for the sales force, while putting the resources closer to the customer to improve sales productivity and retention.

You can also see that improved operating efficiency when you consider that we lower our marketing spend by more than 25% year-over-year during this first quarter, while increasing postpaid phone gross adds by more than 10%.

Bottom line is we're focused on providing a competitive price to consumers while still growing the average billing per user to drive profitability. In fact, the postpaid phone average billings per user of our gross adds in the quarter was actually higher than the average billing per user of the customer that left us in the quarter.

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

Tarek A. Robbiati

Chief Financial Officer

Thank you, Marcelo. Moving to revenue on Slide 10, consolidated net operating revenues were \$8 billion for the quarter and have now stabilized at that level for the last five quarters. Most importantly, wireless net operating revenues of \$7.6 billion grew 1% year-over-year.

Services revenue of \$6.5 billion for the quarter was down 7% year-over-year 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 wireline revenues.

However, it is important to note that retail wireless services revenue and postpaid services revenue have now stabilized for the last three quarters, underscoring the company's focus on improving the top line.

Postpaid average total billings per account was up nearly 4% year-over-year to \$170.56 for the quarter. Looking at postpaid phones specifically, postpaid phone average billings per user of \$72.17 for the quarter increased 3% year-over-year, continuing to grow the monthly cash flow stream from our customers.

69% of postpaid device sales in the quarter were financed, which is up roughly 5 percentage points from the run rate of the prior quarters, and includes 75% of postpaid phone sales being financed. This quarter, roughly 44% of postpaid sales selected our device leasing options, which was in line with last quarter.

At the end of the quarter, we had 64% of our postpaid phone base now being on unsubsidized rate plans. If we assume that over the intermediate term we will not likely exceed 90% penetration due to business and other legacy plans, then you can see that only about a quarter of our postpaid phone base remains to be transitioned to unsubsidized rate plans, which will help future [ph] of the trend (15:22).

Regarding our operating expenses on Slide 11, we continue to make progress on transforming the cost structure of the business to get to free cash flow generation. We realized over \$550 million in net reduction in operating expenses year-over-year in the first quarter across cost of services and selling, general, and administrative expenses.

Cost of services for the quarter of \$2.1 billion was down nearly \$300 million year-over-year, driven by lower wireless network expenses as well as lower wireline cost consistent with our decision to deemphasize certain voice services.

Selling, general and administrative expenses were \$1.9 billion in the quarter and improved by \$270 million from a year ago across several areas of the business, including lower marketing, bad debt, IT, and customer care expenses.

Cost of products of \$1.4 billion for the first quarter increased slightly from a year ago as lower retail upgrade volumes were offset by lease payments associated with the first sale and leaseback transaction with Mobile Leasing Solutions. In addition, there was \$120 million related to losses on leased devices for the quarter recorded in other net on the P&L.

We are confident in our plan to achieve a sustainable reduction of \$2 billion or more of run rate operating expenses exiting fiscal year 2016, having already achieved significant run rate reductions to-date. As we discussed this last quarter, this \$2 billion or more of exit run rate expense reductions will come from all areas of the business. Furthermore, we are already developing initiatives for additional expense reduction in 2017 and beyond.

Now turning on to Slide 12, our adjusted EBITDA was \$2.5 billion for the quarter compared to \$2.1 billion a year ago, with the improvement primarily driven by the expense reductions that I just discussed, as well as having stabilized top line revenues.

Operating income was \$361 million for the quarter compared to \$501 million a year ago, and we have now reported positive operating income in four of the last six quarters. As Jud mentioned, this quarter included \$113 million of nonrecurring contract termination charges, primarily related to the termination of the wholesale agreement with nTelos, which would have otherwise held operating income relatively flat year-over-year, as the higher adjusted EBITDA that I discussed was largely offset by higher depreciation expenses associated with a growing base of device leases.

Turning to CapEx and cash flow on Slide 13. Cash capital expenditures were approximately \$900 million in the quarter, driven by lower capital spending on the network as a result of software driven deployment of capacity through carrier aggregation, as well as lower CapEx related to devices leased in indirect channels.

We are actively securing permits in accordance with our densification plan and we expect site acquisitions and the associated CapEx to accelerate as we progress through the year. As Marcelo discussed, Sprint is uniquely positioned to operate at a lower capital intensity as a result of our tri-band LTE network foundation today and our deep spectrum position.

In addition, with only about a quarter of our 2.5GHz spectrum deployed today, Sprint is well positioned to meet the growing data demands with primarily software-driven deployments of multiple carrier aggregation with three-carrier aggregation next on the horizon to further increase the capacity and speeds for customers.

Net cash provided by operating activities of \$542 million improved from \$128 million a year ago as a result of improved operating expenses and favorable changes to working capital.

Adjusted free cash flow, which includes all net cash flows associated with devices, was positive \$466 million for the quarter, compared to negative \$2.2 billion in the year ago quarter. The year-over-year change was driven by the expense reductions that I discussed, as well as, lower capital spending.

We received approximately \$850 million of net proceeds from our leasing facilities with nearly \$1.1 billion in proceeds from our second transaction with MLS, partially offset by repayments on the second tranche, as well as repayments against proceeds recognized in the prior quarter for future lease receivables.

Shifting focus to liquidity on Slide 14, we ended the quarter with a total general purpose liquidity of nearly \$11 billion, comprised of cash, cash equivalents and short-term investments of \$5.1 billion, \$3 billion of undrawn borrowing capacity under our revolving bank credit facility, and \$2.5 billion of undrawn capacity under our new unsecured financing facility at the end of the quarter.

During the quarter, we successfully doubled our general purpose liquidity with three important transactions. As previously communicated, we completed the financing transaction related to certain existing network equipment receiving \$2.2 billion in cash proceeds. In addition, we executed the second transaction of certain devices with Mobile Leasing Solutions, and received approximately \$1.1 billion in cash.

Lastly, we signed an 18-month senior unsecured facility, which was increased to \$2.5 billion from the \$2 billion original figure during the quarter. In addition, we still have \$1.1 billion in undrawn availability under our network vendor financing facilities that can be used to finance the purchases of 2.5GHz network equipment.

We have now held our net debt relatively constant for the last three quarters, and I would highlight that within that number we now hold over \$5 billion of cash compared to approximately \$2 billion in prior quarters. When you consider that much of the \$5 billion in cash on hand today will likely be used to retire upcoming debt maturities, and the company is getting closer to free cash flow generation, Sprint is clearly in a better place than it was before.

We have a well-defined liquidity strategy underway when you combine the improved trends in our revenue and operating expenses, our existing liquidity sources, anticipated handset and receivables financing transactions, and a potential financing involving securitization of a small portion of our 2.5GHz spectrum assets expected to be completed later this fiscal year. We expect that we will have adequate sources to provide all the capital necessary to fund the business and repay the debt maturities due in fiscal year 2016.

Now let's look at fiscal year 2016 guidance on Slide 15. As we communicated last quarter, we expect adjusted EBITDA to be between \$9.5 billion and \$10 billion driven by the significant cost reductions that I discussed, in addition to growing operating revenues supported by service revenues that have stabilized on a quarterly basis.

In addition, we continued to expect operating income of \$1 billion to \$1.5 billion in fiscal year 2016, as a result of the revenue and expense improvement that I just mentioned. We continue to expect cash capital expenditures, excluding leased devices, to be approximately \$3 billion as we remained focused on maximizing our capital efficiency, while we execute our densification and optimization strategy and utilize the expanded toolbox of various cost-efficient coverage and capacity options.

Lastly, we continue to expect adjusted free cash flow in fiscal year 2016 to be around break-even.

Thank you. I'll turn the call back to Jud to begin the Q&A.

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Jud Henry

Head-Investor Relations

Thanks, Tarek. In just a moment, we'll begin the Q&A. Kristy, please inform our participants on how to queue up for the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Amir Rozwadowski of Barclays.

Amir Rozwadowski
Barclays Capital, Inc.

Q

Thank you very much, and good morning, folks. I was wondering if we could talk a bit more about the network strategy at this point. It seems clear based on some of the third-party metrics that you folks have highlighted that there has been demonstrable improvement when it comes to the network quality. But, I believe, Tarek, you mentioned that only about a third of the 2.5GHz has been deployed at this point. So just trying to assess your comfortability in retaining that lower-capital intensity versus your peers, or how we should think about the longer term progression in terms of capital intensity for the business?

Tarek A. Robbiati
Chief Financial Officer

A

Good morning Amir, it's Tarek here. Thanks for your question.

This is really a very important part of our strategy. The importance of 2.5GHz is very much central to everything we intend to do. Right now, as Marcelo foreshadowed in his speech, there our 2.5GHz spectrum carries already the majority of the data traffic. And so when you look at our capital intensity moving forward, there are four key considerations to apply. The first one is, how do we execute our CapEx investment plan in accordance with site acquisition permits as they come through. We feel good about the site acquisition permits as they stand. And we will invest as the permits come through.

The second aspect of it is that this is really critical to understand. We are investing in new structures which we call small sites, that are built around macro towers. And these small sites cost about 20% of the cost of a tower. So when you really project your CapEx, please do not extrapolate linearly from the past, because we are talking about a very different type of structure.

The third consideration, and which is fundamentally the most important one, and it's what's happening to the customer base and how is the customer experiencing our network? And really, from your perspective, probably the core metric is customer churn. Our churn has never been any better than what it is today, and we feel very good about it. We monitor this religiously. Should we see any impact on churns from the network, we will have no hesitation investing money. But, so far, we feel very good about it because of the amount of spectrum that we have deployed, and also the fact that we still have a fair bit of capacity given the historical investments that we've had with Network Vision.

The fourth consideration is there's a lot of what we do around network investment that is done by software. So, we have invested in carrier aggregation in the first quarter and added 33 more markets in Q1 with two-carrier aggregation. We're progressing also very swiftly to three-carrier aggregation.

So these are the four key things. First, in permits; second, the small site structures; third, the churn and capacity from historical investment; and fourth, our ability to continue to build the customer experience with software investments.

Amir Rozwadowski

Barclays Capital, Inc.

Q

That's very helpful. And if I may, one follow up. In terms of the opportunities for further cost reductions, I mean you folks have been very diligent in outlining some of where those cost reduction opportunities have been. We've seen a noticeable improvement when it comes to your EBITDA margins. How should we think about forward progression in terms of cost reductions? Is there another set or opportunity for further cost reductions if we look into fiscal 2017 and beyond where the business is? Are we at that exit run rate where you feel comfortable in terms of the operations of the business?

Tarek A. Robbiati

Chief Financial Officer

A

Amir, we're never comfortable and we don't rest on our laurels. We'll continue to seek opportunity to improve our cost base. That's why when we guide you and the market, we talk about exit run rates into fiscal year 2017. There is a cost cutting story that extends in our plan on a multi-year basis beyond fiscal year 2016. Fiscal year 2016 is just the beginning, and we're executing our transformation plan across all our cost base, whether it's SG&A, cost of services, and also cost of products, but to a lesser extent, for this year and the next and beyond.

Amir Rozwadowski

Barclays Capital, Inc.

Q

Thank you very much for the incremental color.

Operator: Next question comes from John Hodulik of UBS.

John Christopher Hodulik

UBS Securities LLC

Q

Great. Thank you. Maybe first to follow-up on the last question, Tarek, on the cost of services down \$300 million year-over-year, could you give us a little bit more color on how you're removing these costs from the network, while at the same time expanding on the small sites and infrastructure to improve the network? And then maybe, Marcelo, some comments on the broader competitive environment? You guys are back in there, obviously, with higher gross adds. What are you seeing from the other carriers and are you comfortable that you can maintain these porting ratios that you talked about this quarter? Thanks.

Tarek A. Robbiati

Chief Financial Officer

A

All right. Okay. Let me talk to you about our cost reduction plan on the network side. There are several levers we can pull. First of all, we are very careful around roaming charges, and we are deploying our network to ensure two things, first of all that we deliver, of course, the right customer experience, but in doing so, minimize roaming charges. There is also a lot of benefit stemming from the WiMAX shutdown, which saves a fair bit of [ph] hide costs (29:40) with the removal of WiMAX, old sites that we no longer use, and repurposing the 2.5GHz spectrum for LTE. Third, there is a lot of progress in our wireline business around the migration away from TDM into IP connections. This is essentially what drives our reduction in cost of sales and we see further upside from here on. Let me pass it on to Marcelo to talk about competition and how he sees us moving forward.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

Hi, John, and thanks for your question. From the time that I started running Sprint, I've seen the market get more and more competitive on a quarterly basis. We see all national carriers fighting for the most important customers, which is the handset postpaid customer. We've seen Verizon do price changes. We've seen AT&T bring back unlimited. We've seen Verizon and AT&T for the first time mostly in history to actually offer to pay the \$650 in termination fees.

What is remarkable for us is even as the market is competitive, last quarter was a very special quarter for us due to the fact that we were net port positive against all three carriers. In the past, we had been net port positive against two and now the fact that we've added T-Mobile to the club it's actually good, and this is constant. We continue to gain momentum. This month was – it is a remarkable good month, also. So it's competitive.

Now, we have a good offer, and our offer is comprised of being aggressive not only on the handset side, by offering many sort of different combinations, but also on the rate plan. And as you know, our lead to offer has been a 50% reduction of other competitors' rate plans. But what everybody needs to look is what happens to our average billing per user, and we've been very disciplined at attracting customers at a 50% discount, which most of them actually keep their existing rate plan and additional more data. And in addition, we've continuously been upgrading or raising prices for unlimited customers. So, all-in our average billing per user continues to grow quarter-over-quarter.

We expect the market to continue to be as competitive as it is right now, and we think we're in a really good place right now, especially with our marketing campaigns that we've launched that are having very good effect upon Sprint.

John Christopher Hodulik

UBS Securities LLC

Great. Thanks, guys.

Q

Operator: The next question comes from the line of [ph] Matthew Nickman (32:21), and that's Deutsche Bank.

Q

Hey, guys. Thank you for taking the question. Just one on the back of the last question. In light of what you've been able to put up in terms of postpaid churn improvements, how sustainable do you think this type of improvement is in forward quarters? And then another one on guidance, almost \$2.5 billion in adjusted EBITDA this quarter. There's continued roll through of cost savings initiatives in upcoming quarters. It seems like you would be trending towards or above the high end of adjusted EBITDA guidance for the year, the \$10 billion mark. So, are there other factors to consider in upcoming quarters which might temper this expectation? Thanks.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

So, when we talk about churn, we just reported our lowest ever postpaid phone churn of 1.39%, which was down 10 basis points year-over-year. We don't anticipate any changes. We're putting a lot of our energy towards keeping our customers happy. But I think the most remarkable part is the network experience that our customers are getting. You can see, I mean, churn is the voice of the customer, whether they're satisfied for the value they're getting and the quality of the product, and it's been, I think, six consecutive quarters in which we continued to drive churn down in pretty much in, I'd say, relation to the company's performance, many times it's record churn. So we feel very good as it relates to churn.

Obviously, the best way to grow is by keeping your customers. So last quarter was a good quarter in terms of that we're able to increase our gross adds, while at the same time lowering churn. So that way you get a ripple effect, and we expect that to continue.

As it relates to taking cost out, we are relentless in our cost savings initiatives that we have. We have a lot of different transformational initiatives. This is not a – as Tarek said before, what you can see now is not run rate savings. We're going to continuously do it year-over-year. I think we've been successful at taking cost out for two consecutive years, and we will continue to do it in future years. So that is part of our turnaround to continuously gain efficiency and take more cost out of the system.

Q

I guess maybe just to follow-up, if I think about \$2.5 billion in the first fiscal quarter of the year, incremental cost savings rolling through, and the ability of the company to actually stabilize the top line. Are some of these cost savings initiatives being reinvested elsewhere?

Tarek A. Robbiati

Chief Financial Officer

A

So, let me elaborate on this and I want to pick up your prior question on guidance.

There is a clear commitment from us to make sure that the cost savings we generate trickle down to the bottom line. It's really important that we get those run-rate savings that effectively are going to improve our free cash flow. Our commitment is to get to a point where we are attaining positive free cash flow, including the proceeds from handset financing. And we did well in the first quarter, but we've got to keep going and that is our primary objective.

Now, as we execute, of course, the top line for us is really, really important to maintain, and it's very important also to make sure that we keep the momentum in acquiring customers to emerge strongly from fiscal year 2016 to fiscal year 2017. So there is an element of -- in the way we execute where we will continue to fuel the growth moving forward for the years to come. So far, we feel good about the guidance that we put forth at EBITDA level, because it is early stage in the fiscal year and we feel that we still have to have the right level of visibility on some of the transformation initiatives that we're executing, and this is why our guidance remains what it is, which is at adjusted EBITDA of \$9.5 billion to \$10 billion for fiscal year 2016.

Q

Great. Thank you.

Operator: And your next question comes from the line of Jason Kim of Goldman Sachs.

Jason K. Kim

Goldman Sachs & Co.

Q

Great. Thank you for taking my questions. Just six months ago the market was worried enough about the company's liquidity profile and your 19 bonds traded at a 20% yield. And now those same bonds are at par, up 30 points from the lows, and I know in the past you've talked about having enough liquidity sources to address all of

your debt maturities coming due this fiscal year. But I'm curious to hear your thoughts about your perspective on managing your balance sheet beyond this fiscal year and when you think it's appropriate to start taking advantage of the much improved sentiment towards your credit from the high yield market. And as I look at where your debt is trading right now, and specifically the junior guarantee bonds, they're now trading in the 5% range before the 2020 maturities. So at least on paper when your \$3 billion worth of 9% junior guarantee notes come due in 2018, that is actually an interest savings opportunity for you over time if you refinance them at the same level, and that's not even using your secured debt basket?

Tarek A. Robbiati

Chief Financial Officer

A

Thanks, Jason, for asking the question. Of course it's top of mind for me and for everyone at Sprint. Look, if you really look at the past three quarters from September, we have right now about the same amount of net debt that we had in September. However, our liquidity profile is much, much improved. And we are doing so precisely to pay the maturities as I told you, particularly the fiscal year 2016 one that mature. And our focus is on, in doing so, on improving operating performance and continuing to drive towards being free cash flow positive.

So there will be a point in time where our focus will shift from actually raising liquidity, I would say, expensively in some cases, as has been the case in the past, to driving our interest expense down. And that is really critical, because when you really look at our interest expense, it is a fairly large sum of money on an annual basis, and once we have a clear sight on our ability to generate free cash flow, we'll take a look at different strategies to drive down debt, and in doing so reduce our interest expense going forward.

Jason K. Kim

Goldman Sachs & Co.

Q

Thanks for that. If I can follow up with one more question. The unsecured bridge financing commitment was raised from \$2 billion to \$2.5 billion this past quarter. And my understanding was that this bridge was earmarked to be eventually replaced by your Spectrum Co proceeds. So, in terms of the size of the bridge getting upsized, is that just a reflection of your expectation for the [indiscernible] (39:23) moving up? And maybe as a related question, the \$2.5 billion number, is that your best estimate of the ultimate size of the Spectrum Co? Or is that at the low or high end of your expectations for proceeds?

Tarek A. Robbiati

Chief Financial Officer

A

Okay. So we upsized the bridge because we saw an opportunity to do so. We never linked the bridge with the ability to raise money by – through our spectrum position. So there is no real linkage between the headline figure for the bridge of \$2.5 billion and the value that we would be potentially generating or the amount of money we would potentially be raising from Spectrum Lease Co. Spectrum Lease Co is proceeding well and we are on track to do it by the end of the year. And my focus here is again to minimize cost of capital, really important moving forward, and the bridge will continue to be there for as long as we needed. We haven't drawn on it, we don't intend to draw on it unless it is necessary or we feel comfortable with the current position that we have.

Jason K. Kim

Goldman Sachs & Co.

Q

Thanks for your thoughts.

Operator: And you have a question from Jennifer Fritzsche of Wells Fargo.

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Q

[audio gap] (40:43) my question. I wanted to ask a little bit. There has been some recent noise and pushback about the special access reform by some of the ILECs and cable companies involved on the other side of the process. Can you talk a little bit about your view there? I assume any sort of savings isn't reflected in guidance – longer term guidance, but can you quantify your exposure there and just your thoughts on the procedure from here? And then I wanted to ask a little bit about three-carrier aggregation. Am I correct in saying right now only one of your devices now has it? I guess the obvious question is any thought on future devices, especially some iconic devices coming down the pike would be helpful.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

Thanks, Jennifer. As it relates to special access, we're thrilled that once and for all this is being looked at by Chairman Wheeler, and we believe that the outcome is going to be positive for Sprint, but more importantly that the outcome is going to be positive for the industry as special access becomes quite relevant through the launch of 5G. Obviously, we can't comment on the status of what is going on in the FCC, but we remain very optimistic that the FCC, like I said, once and for all is going to take this one on and make sure that there's fair pricing across the board in order for us to compete better. As it relates to three-carrier aggregation, I'm going to pass it on to John Saw, who'll give you a status of when do we plan to deploy 3CA and how many devices we have on board.

John C. B. Saw

Chief Technology Officer

A

Hey, Jennifer. Just as a background, 74% of our postpaid sales in the quarter was CA capable, so there has been a rapid improvement and increase in CA capable phones. In terms of 3CA phones, we have five today that support three channel carrier aggregation including the Samsung Galaxy S7 and the GS7 Edge. Three more we haven't really announced yet, but we will be doing some demos around that. So, the array of devices supporting CA is going to continue to increase and we expect to be rolling out upgrades to the network to support three channel carrier aggregation in a couple of months.

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Q

And, John, if I may, may I just ask the data speed difference between 2CA and 3CA in the theoretical lab setting?

John C. B. Saw

Chief Technology Officer

A

Well, in the lab testing that we have actually shown some results when the Galaxy S7 was first released, we were actually showing about 300 megabits per second in the lab. We expect, in actual deployments, customers should see speeds in excess of 200 megabits per second peak speeds. With the two channel CA phones today that has been released, we do see the customer's experience improving significantly, and if you look at what's reported in the press, you can see anywhere from between 50 megabits per second to 120 megabits per second. So there has been a significant increase and with three channel CA we expect the peak speeds to increase significantly. But more importantly, what this really means for our customers is that the capacity for those networks and for those sites with carrier aggregation is also going to improve. So that's going to raise everybody's experience.

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Q

Thank you very much.

John C. B. Saw
Chief Technology Officer

A

Thank you.

Operator: And your next question comes from Brett Feldman of Goldman Sachs.

Brett Feldman
Goldman Sachs & Co.

Q

Thanks for taking the question. And just coming back to thinking about the sustainability of your improved operating metrics in postpaid, one of the things that seems to have helped you regain your footing in the market are your promotions, including 50% off. But a common question we get from investors is just what portion of your base is now on these promotional price points? And the reason I have to question it is because they're time limited. And so, we're just trying to assess how many of your customers at some point over the next 12 to 24 months are going to see their price points change and what's your strategy for making sure that there's no hiccup in operations as you go back to them and try to get them reset on a more permanent pricing structure? Thanks.

R. Marcelo Claire
President, Chief Executive Officer & Director

A

Brett – so, our number one area that we put a lot of focus on is basically look at the monthly stable cash flows from the customers' total billing. That's basically our average billing per user. And if you see, we've been pretty constant quarter-over-quarter in terms of that moving in the right direction. If you just look at postpaid phone, average billing per user was \$72.17. That's up 3% year-over-year. So this reflects higher lease revenue offsetting lower service pricing.

And another important point that you might want to look at is our average billing per user of phone gross adds in quarter was actually higher than of phone deactivations. So, again, as you relate to the 50% off, you cannot assume that customers come in and they basically get 50% off. What most customers do is they like to keep on paying the same they were paying before, and therefore, get a higher amount of data on their plan. So we feel relatively good with that.

Now the 50% off promotion is not going to go on forever, right? There will be a time in the not so distant future in which we're going to go back to traditional rate plans and we are doing some testing of other rate plans. And as we get more momentum in the market like we're doing now, then it's going to be the time to always increase pricing. We've been very constant since day one. While perception of our network was lower, we needed to basically play a pricing game. As the perception of our network gets better, which we are seeing it today through churn and others, you're going to see us obviously move price up.

The 50% off has been very successful. We basically, if you look at our postpaid phone net adds was 173,000. That's over 400,000 more than AT&T who has a lot more stores and a lot more money than we do, so we've been able to be very efficient. Also, another area that you might want to look at is we've been able to reduce our marketing spend close by 25% while being able to increase gross adds. So, we're going to continuously monitor the market, test different things. You will see us move pricing up because we're committed to increasing the average billing per user.

Brett Feldman
Goldman Sachs & Co.

Q

And just one quick follow up. I don't think we've gotten this stat in a while. Approximately what portion of your postpaid base is still on unlimited plans?

R. Marcelo Claure
President, Chief Executive Officer & Director

A

We don't like to report on that. What I can tell you is it's right on plan of what we had planned the percent of unlimited customers that we have. So, we like to keep that to ourselves, the percentage of people that we have in our specific rate plans.

Brett Feldman
Goldman Sachs & Co.

Q

Great. Thank you for taking the questions.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Thank you.

Operator: And your next question comes from Phil Cusick of JPMorgan.

Philip A. Cusick
JPMorgan Securities LLC

Q

Hey, guys. Thanks. So, first a couple of things. One is you have a couple of trials out with unlimited plans in the \$50 to \$60 range and I think some people are worried that that could go national. It sounds like you would rather be raising prices. Does that make sense? Or are those trials – could those go national?

R. Marcelo Claure
President, Chief Executive Officer & Director

A

I mean, what we usually do – we have tens of trials across the market and we've learned that the most effective way to test anything that you do is basically by doing real-time trials rather than just doing your traditional consumer testing. That's one of many trials that we have going on. Unlimited has been one of Sprint hallmarks and we believe it is very attractive to a certain segment of the market, so we will continuously test price elasticity to see how could we do it to increase our sales. It's too early to tell what our next promotion is going to be. So, this is nothing more than just a test at this point in time.

Philip A. Cusick
JPMorgan Securities LLC

Q

Okay. And one for Tarek, if I can. Free cash flow, break even this year, and we would expect EBITDA to ramp next year. Would you expect to be in a position where CapEx ramps up and offsets gains in EBITDA so that you go back to free cash flow negative? It sounds like you expect to be free cash flow positive going forward.

Tarek A. Robbiati
Chief Financial Officer

A

Yes, of course. When our goal to get to positive free cash flow is not just a one-off. Our goal is to get to a point where our free cash flow is positive on a sustained basis. And that's why you have all the levers that you can think about being pulled, OpEx costs, modulating CapEx investment, knowing what the historic CapEx investments were, and making sure we get to the point where we have sustained positive free cash flow for the future. It's critical. We've got a number of maturities falling due beyond fiscal year 2016 and we're planning to make sure that we don't get back into negative free cash flow for those maturities that fall due beyond 2016.

Philip A. Cusick

JPMorgan Securities LLC

Q

So we can expect you to be positive free cash flow in fiscal 2017?

Tarek A. Robbiati

Chief Financial Officer

A

Yes.

Philip A. Cusick

JPMorgan Securities LLC

Q

Thank you.

Operator: And your next question comes from Michael Rollins of Citi.

Michael I. Rollins

Citigroup Global Markets, Inc. (Broker)

Q

Hi. Thanks for taking the question. Seems like in the industry right now the device replacement cycle is lengthening and that seems to be helping churn, as well. How would you segment the improvement in your churn between the improvement, or say the extension of the device replacement cycle relative to greater satisfaction with your network and the service that you're providing to your customers? Thanks.

R. Marcelo Claure

President, Chief Executive Officer & Director

A

So at least for us at Sprint, I think next quarter is going to be very telling, or actually this quarter is going to be very telling as it relates to postpaid upgrades. We made a big bet in allowing most of our customers to have the right to upgrade once a year, and as the launch of the new iPhone 7 comes along, it is going to be very telling as it relates to what percent of customers are actually upgrading.

We've done sufficient financial modeling in which we are managing our base very strategically where it actually makes sense at some point in time for us to induce early upgrades so we can have access to those devices, refurbish them and put them back in the market as a lower cost of acquisition. And there are other times in this life cycle of the customer where we are not going to proactively reach for early upgrades. This is a key part to our strategy. We made it clear that we think we have a differentiating advantage by having the ability to get used devices, refurbish them and put them back into the market and be able to, we truly understand what residual values are. That's why we were the first carrier to launch leasing a couple of years back. As it relates to the industry, any time – we've seen it when Apple launched the iPhone 6 that there was a tremendous amount of upgrades and we've seen the form factor changes, which – what is actually the main drivers of upgrades. So, we will see what happens with the iPhone 7.

Michael I. Rollins

Citigroup Global Markets, Inc. (Broker)

Q

And if I could just follow up on one other question to your comment. In the past, you talk about your relationship with Brightstar and the opportunity for Sprint to manage residual values because of your partners. Can you give us an update on how the company is managing the residual value risk of early upgrades with your partners?

R. Marcelo Claire

President, Chief Executive Officer & Director

A

So, we look at early upgrades as a tremendous opportunity to have a lower cost of acquisition for a second set of customers who today cannot afford to buy a new iPhone. So you're going to see us grab some of those phones, again put them back into market into potential alternate brands. And then secondly, being Brightstar, the world's largest reseller of used devices, we work together to understand the residual value curves and be able to actually optimize, and in many cases, generate additional profit through the sale of devices. That is a key part of our strategy, the relationship with Brightstar. While we don't have a guaranteed commitment to buy back devices, we do not feel that we have any material risk. We actually see it as – I wouldn't call it material, but we see it as an upside in how we match our leasing products.

Michael I. Rollins

Citigroup Global Markets, Inc. (Broker)

Q

Thanks very much.

Operator: And you have a question from David of Bank of America.

David William Barden

Bank of America Merrill Lynch

Q

Hey, guys, thanks for taking the question. Tarek, we've been talking a lot about the kind of free cash flow breakeven on an adjusted basis, which includes the handset financing that you have to kind of keep going out to the market to try to achieve. Two questions on that. Number one would be, when do you think you'll be able to get to a point where you can be self-sustaining from an operating cash flow meeting capital expenditure basis? And second, as you look at the ABS financing that Verizon did with their handsets as an option, could you talk about that as a potential for your business? Thanks.

Tarek A. Robbiati

Chief Financial Officer

A

Okay. So, David, from a cash flow perspective, our goal is to maintain and sustain positive free cash flow from fiscal year 2016 onwards. And if you really look at the industry, and you know this, every carrier in the United States has an element of handset financing proceeds accounted for in the non-GAAP measure, which we all call reported free cash flow. We have that by way of accounts receivable securitizations. This is what every other carrier does. But we also have, on top of that, the proceeds of MLS transactions, as we call them internally, which we account for, hence showing also the adjusted free cash flow metric, which includes the sale of certain devices that we do from time to time with MLS. So this idea that you need to have handset financing accounted for is a function of the fact that capital intensity in the industry has changed materially with the advent of smartphone. And this holds true for pretty much every carrier around the world. And so it's really important that we factor in the working capital drag and find ways to combat the working capital drag associated with handset costs.

Of course, at some point, we need to attain the point where our free cash flow excluding the working capital benefit from securitizations and MLS transactions is positive. And that is a few quarters out. As we cut cost and as we continue to grow our top line, we will get there eventually. Now, back to your point on the EBS transaction of Verizon, the natural evolution of the transactions we did with MLS is to move into the termed market. And that is something that we foreshadowed and that's why we created the MLS structure back in November in the first place because if you look at it from a bank standpoint, the banks who fund MLS transactions are subject to their own regulations on the Basel III, Basel IV. And from their perspective, there's only that much of these assets that they consider to be illiquid that they can hold on their own balance sheet, because it affects their liquidity ratio, and therefore will affect the return on equity calculations of the banks.

And so the intent over time is to evolve our MLS type of structure to a combination of banking financing, so financing led by banks, and also tapping into the securitization market as Verizon just did. This is a natural evolution for every player in the industry.

David William Barden

Bank of America Merrill Lynch

Q

Great. Thank you so much.

Jud Henry

Head-Investor Relations

That's all the time we have for questions. But before we end the call, I'd like to turn it back to Marcelo for some closing comments. If you have additional questions following the call, please contact the Sprint Investor Relations team. Marcelo?

R. Marcelo Claure

President, Chief Executive Officer & Director

Great. Thank you. So I want to thank everyone for joining us today, and for your support of Sprint. I think we made good strides in our transformation in the first quarter, and I look forward to sharing further progress with you next quarter.

I'm really proud of the sales and marketing teams for becoming postpaid net port positive against all three national competitors in the same quarter for the first time in over five years, and delivering the most postpaid phone net additions for the first quarter in the last nine years at Sprint, excluding the Nextel migrations. And this is a result of growing our share of postpaid phone gross additions and delivering the lowest postpaid phone churn in the company's history.

I'm equally proud of the financial improvements we made by growing wireless operating revenues, cutting our operating expenses, generating positive operating income for the fourth time in the last six quarters, and generating nearly \$11 billion of available liquidity. We feel very confident that our densification and optimization strategy is going to further unlock the value of our spectrum holdings to provide customers the best experience, and I believe that Sprint will be best positioned of all the carriers for the growing data demands of consumers in the future. So thanks again, and have a great day.

Operator: And thank you all for participating in this morning's conference. You may now disconnect.

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