Corrected Transcript

25-Oct-2016

Sprint Corp. (S)

Q2 2016 Earnings Call

CORPORATE PARTICIPANTS

Jud Henry
Vice President & Head of Investor Relations, Sprint Corp.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

John C. B. Saw
Chief Technology Officer, Sprint Corp.

OTHER PARTICIPANTS

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Brett Feldman
Analyst, Goldman Sachs & Co.

Amy Yong
Analyst, Macquarie Capital (USA), Inc.

John Christopher Hodulik
Analyst, UBS Securities LLC

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

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

Colby Synesael
Analyst, Cowen & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for standing by. Welcome to the Sprint Fiscal Second 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 open for questions. I would now like to turn the call over to Mr. Jud Henry, Vice President of Investor Relations.

Please go ahead, sir.

Jud Henry
Vice President & Head of Investor Relations, Sprint Corp.

Good morning, and welcome to Sprint's quarterly results conference call. Joining me on the call today are Sprint's President and CEO, Marcelo Claure, and our CFO, Tarek Robbiati. 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 2 is our cautionary statement. I want to point out that, in our remarks this morning, we will be addressing 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'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. Also, all references to customers or connections in our remarks represent results or expectations for the Sprint platform, unless otherwise indicated.

Lastly, we will be limited in our remarks today related to our private placement of spectrum-backed senior secured notes because the transaction is not expected to close until this Thursday, October 27.

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

R. Marcelo Claure

President, Chief Executive Officer & Director, Sprint Corp.

Thank you, Jud, and good morning, everyone. We have continued to execute on our turnaround plan with strong results in the second quarter. Our postpaid phone net additions were up five times over a year ago, and double our net additions from last quarter. This was driven by our best-ever postpaid phone churn in Sprint's history, and continued growth in postpaid phone gross additions. In addition, Sprint remained postpaid net port positive against all three national carriers for the second consecutive quarter. At the same time, we have grown operating revenue year-over-year, while continue to reduce our cash operating expenses. We had over $11 billion of liquidity at the end of the quarter, and expect to close the $3.5 billion spectrum-backed financing transaction at an incredible interest rate of 3.36%, this is less than half of the last time we went to the market. In addition, we continue to see third-parties recognizing the quality of our network.

Turning to slide 5, our customer growth continued in the second quarter, with 740,000 total net additions in the quarter. Postpaid net additions for the quarter were 344,000. And as I mentioned a moment ago, we were postpaid net port positive against every national carrier this quarter for the second consecutive quarter.

Furthermore, we improved our porting ratio against all three carriers quarter-over-quarter. This growth was entirely from the highest profit contribution category of our business, as our postpaid phone net additions of 347,000 for the quarter improved by over 5 times year-over-year, and our 520,000 phone net additions in just the first half of fiscal 2016 is nearly 20% more than what we did in full last year. This growth in our postpaid phone base was partially driven by the fact that our postpaid phone gross additions were up nearly 20% year-over-year in the quarter. This equates to an estimated 400 basis point increase in share of industry postpaid phone gross additions. Moreover, our postpaid phone net additions were nearly 400,000 more than Verizon this quarter and 700,000 more than AT&T in the quarter. We have now surpassed Verizon and AT&T for three consecutive quarters in postpaid phone net additions.

In addition, postpaid phone churn was again the lowest in the Sprint's history at 1.37% and improved by 12 basis points from last year. This makes seven consecutive quarters of year-over-year improvement in postpaid phone churn, and it speaks to the continued improvement in our network and our consumer value proposition. This improved momentum also helped us improve sequentially as well. When we normally see a seasonal increase, our postpaid churn improved by two basis points 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 427,000, driven by continued intensity in the prepaid space, as well as the impacts of repositioning some of our prepaid brands this year. Prepaid is an important part of our business, and we're completely overhauling our prepaid brands. We're materially tightening the customer engagement criteria for base, and as a result of these changes and the current run rate of our prepaid business, we expect to have approximately two million fewer prepaid customers in the base at the end of the fiscal third quarter. Each of our prepaid brands has different churn rules and retention programs, and we're now bringing them all into the same program, which will be tighter than any of the brands were previously. However, because we're only eliminating customers with no or low engagement, we do not expect a material impact to our prepaid revenue.

Lastly, our wholesale and affiliate business continued to grow with net additions of 823,000.

Now let me update you on the progress of the network on slide 6. As you can see, 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 customers the absolute best experience. It is great to see so many third-parties highlighting improvement in the Sprint's network quarter-after-quarter. For example, Nielsen Mobile Performance data shows that Sprint continues to deliver the fastest LTE download speeds compared to Verizon, AT&T, and T-Mobile, based on how [ph] real (6:21) customers are actually experiencing the network, by using crowd-sourced data that is always being collected uninterrupted in the background. Drive test from Nielsen show that Sprint's network reliability has improved dramatically in the last two years and continue to be within less than 1% of AT&T and Verizon.

You can also see the improved quality of our network in the results from independent mobile firm analytics, RootMetrics, with 52% more first place RootScore Awards in the 70 markets measured in the second half of 2016 compared to the first half of this year. Most recently, J.D. Power, the leading independent industry benchmark, now ranks Sprint second for wireless network quality performance in five out of six geographic regions in the U.S. in its 2016 Wireless Network Quality Performance Study.

While we're pleased to see third-parties show that our network is very competitive today, we remain focused on our densification and optimization strategy to deliver a great network in the future by improving the cost and performance of the network, as you can see on slide 7. Sprint has more spectrum deployed on LTE per customer than any other national carrier today, and no other company has the spectrum to unlock the power of carrier aggregation like Sprint does. LTE Plus is now available in over 250 markets, and Sprint has already started to deploy three-channel carrier aggregation in several markets, which is expected to provide peak download speeds of more than 200 megabits per second on capable devices when available. We currently have 10 three-channel carrier aggregation capable devices, including the recently launched iPhone 7 and Samsung Galaxy S7.

In addition, 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 United States. We're expanding the many tools in the toolbox today for maximizing network performance as well as efficiency of capital and operating costs. With these tools, the cost to build and operate this densification site are expected to be materially less than our microsite built in the past. Our densification and optimization plan continues to build momentum as we double the number of permits received quarter-over-quarter. We continue to bring more small cells on air, and now we have close to 200 small cells on air in Manhattan, in New York City alone, for example. Lastly, with over 90% of our total data traffic now on LTE, we continue to convert additional channels for our 1.9 gigahertz spectrum to LTE to further enhance our mid-brand LTE layer as well.

Moving to slide 8, we continue to evolve our value proposition on the back of our improved network. You can see this reflected in the year-over-year improvement in both our postpaid phone gross additions and our postpaid phone churn. We have been listening to our current and prospective customers about what they really want from a wireless carrier. We heard a lot of frustration and confusion of our unlimited wireless plan, many of which focus on gigabyte, data limit, and extra charges like access fee. As a result, we launched Unlimited Freedom in August, giving customers value and simplicity, with a simple and straightforward plan with no access charges or hidden fees.

Coupled with Sprint's reliable network, customers get the best price among all carriers and can enjoy as much data, worry free, as they want. Customers have responded positively to the offer with roughly half of new customers already choosing Unlimited Freedom since the launch in mid-quarter. Sprint is known for unlimited data, and it's part of our heritage, while some of our competitors no longer offer unlimited data or make it hard to get. With the capacity and reliability for LTE Plus Network and our deep spectrum position, we are uniquely positioned to deliver data traffic. We're able to begin to dramatically simplify our rate plans and give customers the peace of mind to not think about their data plans anymore.

This will have a ripple effect across the operations and customer relationships, including a reduction in $1 billion related cost to care, and we want to be easy to do business with and easy for a sales rep to execute.

Bottom line, we're focused on providing a simple and affordable service to customers while still growing the average billings per users to drive profitability. In fact, we continue to see the postpaid phone average billing per user for gross additions in the quarter was actually higher than the average billing per user of the customer that left us in the quarter. We would expect an improvement in gross add ARPU in the future, and more customers are loading on Unlimited Freedom and less on the 50% off promotion.

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

Tarek A. Robbiati

Chief Financial Officer, Sprint Corp.

Thank you, Marcelo. Moving to revenue on slide nine, consolidated net operating revenues were over $8.2 for the quarter, growing 3% year-over-year, while Wireless net operating revenues of $7.9 billion grew nearly 5% year-over-year. Service revenue of $6.4 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 enhancing programs as well as lower Wireline revenues. Sequentially, Wireless service revenue and postpaid service revenue were relatively flat. Postpaid average total billings per account was up 2% year-over-year to $170.29 for the quarter, as we are seeing an increased number of phones per account. Postpaid phone average billings per user of $71.69 for the quarter increased 2% year-over-year, continuing to grow the monthly cash flow stream from our customers. 73% of postpaid device sales in the quarter were financed, which includes 78% of postpaid phone sales being financed. At the end of the quarter, we had 67% 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 less than a quarter of our postpaid phone base remains to be transitioned to unsubsidized rate plans.

Regarding our operating expenses on slide 10, we continue to execute on our cost transformation in the quarter. We realized over $580 million in net reductions in operating expenses year-over-year in the second quarter across cost of services and selling, general and administrative expenses. This builds upon last quarter's results to deliver over $1.1 billion in expense reductions year-to-date.

Cost of services for the quarter of $2.1 billion was down $350 million year-over-year, primarily driven by lower Wireless roaming expenses, including impacts from the nTelos transaction, the shutdown of the WiMAX network as well as lower Wireline costs. Selling, general, and administrative expenses were $2 billion in the quarter and improved by $230 million from a year ago across several areas of the business including lower marketing, IT, and customer care expenses.

Cost of products of $1.7 billion for the second quarter increased by $400 million from a year ago, mostly due to a lower mix of lease sales and payment associated with our first sale and leaseback transaction with Mobile Leasing Solutions. In addition, there was $111 million related to losses on lease devices for the quarter recorded in other, net on the P&L.

We're 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 year-to-date. Furthermore, we are already developing initiatives for additional expense reductions in 2017 and beyond.

Now turning on to slide 11. Our adjusted EBITDA was $2.35 billion for the quarter, compared to $2 billion a year ago with the improvement primarily driven by the expense reductions that I discussed as well as having stabilized top-line revenues.

Operating income was $622 million for the quarter compared to an operating loss of $2 million a year ago and we have now reported positive operating income for three consecutive quarters. This quarter included a pre-tax non-cash gain of $354 million related to certain spectrum swaps with other carriers, partially offset by $103 million in litigation and other contingency expenses, while a year ago period included $267 million of items primarily related to network asset dispositions and litigation and other contingency expenses. Excluding these items, operating income would have increased by approximately $100 million year-over-year.

Sprint's net loss in the quarter was $142 million, or $0.04 per share, compared to a net loss of $585 million, or $0.15 per share in the year-ago period. Adjusting for the special items that I mentioned a moment ago on an after-tax basis, our net loss improved by approximately $100 million year-over-year or approximately $0.03 per share.

Turning to slide 12, cash capital expenditures were over $800 million in the quarter with the year-over-year decline driven by lower capital spending on the network as a result of software driven deployments of capacity through carrier aggregation, surgical deployments of small cells, as well as lower CapEx related to devices leased in indirect channels.

As Marcelo mentioned, we continue to secure more and more permits as part of our densification plan and we expect site acquisitions and the associated CapEx to accelerate as we progress through the year. Sprint is uniquely positioned to operate at a lower capital intensity as a result of our tri-band LTE network foundation and our deep spectrum position.

Net cash provided by operating activities of $1.7 billion improved slightly from a year ago. Adjusted free cash flow, which includes all net cash flows associated with devices, was positive $707 million for the quarter, compared to negative $100 million in the year ago quarter. The year-over-year change was driven by lower capital spending as well as the expense reductions that I discussed, partially offset by repayments on the second tranche with MLS and repayments against proceeds for future lease receivables.

Shifting focus to liquidity on slide 13, we ended the quarter with total general purpose liquidity of $11.3 billion comprised of cash, cash equivalents and short-term investments of $5.7 billion, $3 billion undrawn borrowing capacity under our revolving bank credit facility, and $2.5 billion of undrawn capacity under our unsecured financing facility, and approximately $100 million of undrawn capacity under our receivable facility at the end of 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 2.5 gigahertz network equipment.

Last week, we priced $3.5 billion of spectrum-backed senior secured notes. This unique and innovative transaction represents the latest example of the company strategy to diversify its sources of financing in order to lower the company's cost of capital and future rate expense.

We are very pleased to say that these notes priced at 3.36%, which is less than half of our current effective interest rate and is materially less than the coupon on the next maturities coming due. The demand for these notes was strong and the book being oversubscribed, as you probably read in the media.

In conjunction with the expected closing of that issuance this Thursday, the $2.5 billion unsecured credit facility will terminate. We have a well-defined liquidity strategy underway, when you combine the improved trends in our operating revenues and expenses, our existing liquidity sources, and anticipated handset and receivable financing transactions. We expect that we will have adequate sources to provide all of the capital necessary to fund the business and repay the upcoming debt maturities in fiscal year 2016.

Now let's look at fiscal year 2016 guidance on slide 14. We continue to expect adjusted EBITDA to be $9.5 billion to $10 billion. In addition, we are increasing our guidance for operating income from the previous range of $1 billion to 1.5 billion to now expect $1.2 billion to $1.7 billion in fiscal year 2016 as a result of the net gain related to the special items recorded this quarter.

Regarding our guidance for cash capital expenditures, excluding leased devices, we now expect to spend less than $3 billion, given better visibility into the timing of payments related to the densification, as cash payments will lag the siting and construction. We continue to expect to further ramp-up our densification and utilize the expanded toolbox of various cost-efficient coverage and capacity options as we go through fiscal year 2016 and into fiscal 2017. Lastly, we continue to expect adjusted free cash flow in fiscal year 2016 to be around break-even.

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

Jud Henry

Vice President & Head of Investor Relations, Sprint Corp.

Thank you, Tarek. In just a moment, we will begin the Q&A. Let me first remind you that because we are still in the offering period for our privately placed spectrum-backed senior secured notes, we will not be taking any questions on the call today related to the offering and would direct you to the pricing press release from October 20 for more details.

Erica, please inform our participants on how to queue up for the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll pause for just a moment to compile the Q&A roster. Our first question is from Phil Cusick.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Hi, guys. Thanks. So, I'm thinking about the network improving, churns improving, reliabilities improving. Is it time to start to harvest some of the cost savings and invest more in marketing and distribution to drive gross add share higher? How do you think about that?

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Hi, Phil. And thanks for your question. We have a balanced plan – we have a five-year balanced plan to turnaround Sprint. And I think we've done a good job of attracting customers. I mean, if we were to go back in time and tell you that we were going to beat AT&T by over 700,000 handset net adds in postpaid and beat Verizon by over 383,000 handset net adds, and basically be so close [ph] as to T-Mobile (21:51), when you exclude [ph] transfers (21:53), we're only 250,000 behind, when not too long ago we were 1.5 million pretty much behind with all of these other carriers, I think we're doing relatively good in terms of capturing new customers. What we've done from a marketing spend and others, it's remarkable. I mean, we have taken – if I'm not mistaken, our marketing expenses a couple of years back was in excess of $1.4 billion, and this year marketing shouldn't exceed $800 million. So when you look at the type of cost cutting that we've done while increasing sales as it relates specifically to marketing, we're going to continue to basically be disciplined. It's quite easy to just get back on a spending spree. I just think we're smarter in terms of how we're spending our money to attract new customers and how we're spending our money to basically retain the current customers that we have.

So, this is a balanced plan. We're in the middle of it. We're only two years in, or two years in in a quarter, if I'm not mistaken, and this is a five-year plan in order to have a very strong Sprint. But we cannot just go because we've had a successful quarter of attracting customers and just basically increase the spending.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

If I can follow-up on distribution, what's the thought on expanding or putting capital into updating or moving stores? It's been a long time since Sprint put a lot of money into distribution. And then how do you think about online versus retail? Thanks.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Thank you. Let me start with your last question, which is online versus digital – or sorry, online versus offline. What we've done is we embarked on a digitalization journey about a year ago in terms of having grow some of our sales digitally. I'm happy to report that we've had probably the best quarter in Sprint's history from a digital perspective, or from an online perspective. A good amount of our sales now have moved to digital channels. We're talking about a couple hundred percent increase in that specific channel. However, that doesn't take the point away that Sprint had not invested in the past in terms of expanding its physical distribution. We have embarked on a journey. I will say the first part was the RadioShack initiative, and that was mainly a quantity over quality. We needed to add 1,500 stores. They are producing what we expected them to produce. And now what we're doing is, as you know, we have a joint venture with Carphone Warehouse to basically expand our distribution. In addition, we have many dealer openings, and for the first time in a very long time, we plan to remodel some of our stores, relocate some more stores, and starting to add a new company on retail. Our plan is in the next 18 months to increase Sprint's distribution by over 1,000 stores on the postpaid side and we plan to increase prepaid distribution by over 1,500 sites. So, in conclusion, we have a very aggressive digital strategy in terms of growing our business. That is paying off.

The launch of the iPhone 7 was incredibly digital for us from an upgrade and sales perspective, while, at the same time, we need to come up to par to our competitors and be able to increase our physical distribution. Obviously, making sure that we can continue to maintain cost down and be able to lower cost per gross add as we achieve this goal.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Thanks, Marcelo.

Operator: Our next question is from Jennifer Fritzsche with Wells Fargo. Jennifer, please go ahead.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

I'm sorry, I was muted. Thank you for taking my question. On the network, if I could, there's a strong belief, I would say, that many of the gains you're seeing on the network right now are a result more of Network Vision than the path you've seen on small cells. I know you've said that things have been moving forward there. Can you talk a little bit more detailed? Are you using many different vendors with the small cells? And are those ahead of expectations in terms of your gains? And I have one more follow-up after that.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Hey, Jennifer, I'm going to pass it on to John Saw. But at a high level, there is a way in which you can do a lot more with less. And we've proven that you don't necessarily have to have the same level of CapEx investment in order to produce an amazing experience for our customers. You can see by pretty much every single third-party company, including J.D. Power, Nielsen, RootMetrics, that are evaluating our network in terms that our network is getting significantly better.

You are right that we did a lot with Network Vision, and we spent accordingly, as we had the highest spend per consumer or per customer of any other carrier for the last few years, but we have a very aggressive densification plan that you're already starting to see some of the effects. But I'm going to let John Saw address some of your direct questions as it relates to small cells and some markets where we're already starting to see a tremendous improvement.

John C. B. Saw
Chief Technology Officer, Sprint Corp.

A

Hey, Jennifer, John here. Absolutely right. We are building on a foundation that we have laid with Network Vision and building on top of that. And that is a key reason why you're seeing the performance improvement. On top of Network Vision, in the last two years, we have also added a lot of 2.5 gigahertz carriers to our cell sites. That really has moved the needle in terms of how our data speeds have improved. We also added a lot of 800 megahertz as well, to improve coverage, especially indoors. And then we rollout carrier aggregation last year, two-channel CA, and now we're also rolling out three-channel CA. Those have a big impact, as well, on customer experience.

Now, we can be surgical after Network Vision in terms of how we add capacity and performance by using small cells. So far, we have been pleased with the progress that we have made with the small cells. Our permits have doubled from last quarter. Some municipalities have been easier to work with than others. And, overall, we are pleased with the direction. I think Marcelo mentioned the 200 small cells that we have turned up in Manhattan. And we are very pleased with the performance that we have seen in that, it has really moved the needle in terms of our customers' experience there and we expect to replicate this experience nationwide.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. John, thank you for that. And just, if I may, just on the same. I'm not a techie, but I've been reading a lot about the Qualcomm chip versus the Intel chip with the new iPhone. Can you just – am I correct in saying that your version of the iPhone has the Qualcomm chip within it, and that should lead to better download speeds and performance?

John C. B. Saw
Chief Technology Officer, Sprint Corp.

A

Our version of the iPhone 7s do have the Qualcomm chip in it. In terms of its relative performance to the Intel chip, I would let Apple comment on that. Obviously, there has been reports out there that one chip performs better than the others. I would let Apple comment on that. But we are pleased with the performance of the iPhone 7 on our network and early feedback is our customers are very pleased with it as well.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you very much.

Operator: Our next question is from Brett Feldman with Goldman Sachs & Co.

Brett Feldman
Analyst, Goldman Sachs & Co.

Q

Thanks for taking the question. I kind of want to go back to the topic that Phil brought up earlier about thinking about the right level of competitive intensity that you should be putting into the market. And, in addition to having your OpEx improving, you're also improving your balance sheet quite a bit. And, for most of this turnaround period, Marcelo, you've been talking to how important it is that you really focus on very high customer quality, that you be very targeted in who you bring on to the network, but it would certainly seem that as your balance sheet provides you with more flexibility, maybe you have an ability to think more broadly about how you approach the market. And so I guess the real question is, as you improve the maturity profile of your balance sheet, does that actually free you up to think more broadly about what you want to be in the market?

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Thank you. And that's a real good question and one that we debate internally all the time. We don't constrain ourselves in terms of how we're running this company because we've always had a very good plan as it relates on how we're going to manage liquidity. I think what you're seeing now is our ability to raise debt at historically low levels for Sprint. I mean, if you look at where we're priced, it was 3.36%, and that is basically less than half of what we priced when we had the opportunity to issue bonds not too long ago, and it's less than half our current cost of debt that we have today at Sprint. So, obviously you're going to see that as very positive as we start reducing interest expense with just a big line in our P&L.

We plan to use that money smartly. We have some maturities from the Clearwire acquisition that I believe we're at 14.75% interest. So any time you can replace debt of 14.75% with debt at 3.36%, then definitely this is going to be [ph] a credit (31:38). Now, so that as it relates to us, I would say the way we're attacking the market. On a positive side, also, I think both Tarek and myself were very surprised with the tremendous demand that we had for these notes. I mean, we're severely oversubscribed, which is positive when in the past we had to struggle when we had to go out to the market and be able to raise money. Now, does that change the way we operate? Absolutely not. I mean, we're incredibly disciplined in acquiring our customers. We have a cost per gross add that we are religious about it, that we don't want to go over it. We have a plan to enhance our distribution. We're very disciplined as it relates to our network spending. We have a very clear plan in terms of how to deploy our network. So nothing changes the fact that we have access to money, access to money at a lower price. What might change is the fact that we're going to reduce a big line on the P&L that's called interest expense, and hopefully that line is going to allow us to reach net income profitability in the not so distant future. So, that is our plan.

Brett Feldman
Analyst, Goldman Sachs & Co.

Q

Thank you.

Operator: Our next question is from Amy Yong with Macquarie.

Amy Yong
Analyst, Macquarie Capital (USA), Inc.

Q

Thanks and good morning. I wanted to focus on churn and ARPU a little bit more. Marcelo, can you talk about how you're balancing customer care and with touch and efforts in some of the cost cutting measures that you're putting in place? What are some of the leverage that you're pulling? And I think the ARPU growth was pretty impressive in the quarter at 2%. Is that sustainable going forward and what is driving that? Thank you.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Thank you. So we take a lot of pride in what we've been able to achieve from a churn perspective. Our postpaid churn was only 1.37%, which was down 12 basis points year-over-year and two basis points sequentially, when this is a tough quarter to beat sequentially as traditionally churn has gone up in the past when you look year-over-year. Now what is driving this low churn? To be clear, this is Sprint's lowest churn in company's history.

So we've – I think Sprint – the Wireless business has been in business for over 20 years, and the fact that we continue to record, record churn after record churn quarter-after-quarter, is a testament to, I would say, three basic areas. First and foremost, the network. Customers are coming in and, as you can see, they're coming in by the hundreds of thousands from both Verizon and AT&T and T-Mobile, and they're finding themselves with a really good experience. And, therefore, I think the best survey that you can ever do to a customer is called churn. So people are satisfied with the quality of service that they are receiving when they come to Sprint. And people, in many cases, are surprised that our network in many places is the same or better than Verizon. So that's number one.

Secondly is we have a very solid credit strategy. We are bringing customers that pretty much that can pay their bills. We're very disciplined in our credit strategy. And, therefore, if you bring customers that have the ability to pay their bill, then therefore you're going to reduce your churn, and we've done that.

And three is we have a maniacal focus in terms of the customer experience. We are redesigning all of our systems, our processes, our care systems, to make sure that we're providing our customers with a great experience. We still have a long way to go, but I could not be more proud of my team to deliver another record quarter as it relates to churn – handset churn being at 1.37%, which is the lowest we have ever been.

Now if I address the second part of your question, right? It's hard for everybody to predict ARPU these days because of the tremendous balance in mix that you have when customers move from subsidy to different types of financing, such are lease or IB. So we'll look at something that's called average billing per user, which is nearly 2% up year-over-year, and is relatively flat sequentially. Our goal is to continue to increase the amount of billings that we do to our base. As a matter of fact, we have a new group in Sprint that all their entire attention is basically on growing our average billing per users that we have per customers. We have a lot of positive things that are going to come in the future. First of all, as you all know, we have a lot of customers who sign up with a 50% discount. That 50% discount is not here to stay forever. Customers have signed up, in many cases, for a two-year 50% discount, and some of those customers are going to move off of that discount starting the beginning of calendar year 2017.

Now we're going to be very surgical, as in reality, we have the contractual rights to double their bill, but we don't plan to do that. We plan to try to migrate as many as we can into our Unlimited Freedom plan, and that's going to be accretive to the base because they're going to be paying more. Secondly is, as you know, we've put most of our customers off lease in the past. Under scenario of leasing, which I think Sprint and Brightstar have a competitive advantage, and that is the monetization of devices that we have received back from leasing that they have a residual value. We have been very conservative in forecasting that due to the nature of the volatility of the residual value, but we see that as a potential area of value in the future. And, thirdly is, as we rollout Unlimited Freedom, we've had an amazing demand for that product. Already over 50% of customers that are coming in are choosing Unlimited Freedom, and we expect some of our customers in the base that were on 50% off to move to Unlimited Freedom and that will be accretive to our business. So we have a lot of different – I would say, we have a lot of different tools in order for us to manage the average billing per user going forward, and we are determined to increase that sequentially, as we have been doing year-over-year, and we're going to try to continue to do it on a quarter-over-quarter basis. Thank you.

Operator: And our next question comes from John Hodulik with UBS Securities.

John Christopher Hodulik
Analyst, UBS Securities LLC

Q

Great. Thanks. Marcelo, you guys have been making a lot of progress in terms of service revenue trends. When can we expect to see you guys return to service revenue growth? And as part of that, you've seen real stabilization on the postpaid side. Can you give us some details on your plans to turn the prepaid side? And then, lastly, if I may, you've executed well on the cost cutting in 2016. Should we expect another round of cost cutting in 2017, even with the expansion of the distribution that you talked about earlier? Thanks.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

So one of the – I think this quarter is a special quarter for Sprint, because [ph] we were at (38:53) inflection point, because, for the first time, net operating revenue is growing again. And that, to me, any time you start growing revenue again in a company, it's a great sign of a turnaround. As it relates to service revenue, it's a little bit more complex because of the financing mix, right? As we move more people away from subsidy and you put them into financing mix, which is the right thing to do, then you're going to see those changes that you see to the service revenue.

Now, a couple of things that have made us, basically, I would say, not grow our service revenue as much as I would like to, is with the number of phones have increased per customer, or call it the band of customers. Meaning, we have more accounts that have more devices or more phones. As you know, the way this industry prices, the first device, for example, on Unlimited Freedom, is $60, the next one is $40, and the next one is lower. So, even though that might be a little reduction to your service revenue overall, I think it's incredibly positive because families churn a lot less than individuals. You can see it in Verizon and AT&T churn, and they have a lot of families into their business. So we're putting a lot of focus into trying to bring those families. So we feel good in terms of where we are as it relates to service revenue, and make no mistake that we are determined to basically change that trend. I think we were very close this quarter, and we're going to continue to make sure that we can not only increase net operating revenue on a year-over-year basis, but soon we're going to start increasing service revenue year-over-year basis. We're very close this quarter. And it is not too far, the day that, basically, service revenue is going to start going up.

As it relates to cost cutting, this is a transformation, and transformation means you do business – it doesn't necessarily mean that all you do is take cost out or you do layoffs. What you do is you transform the way you do business. We're transforming the way we do our care. We're transforming the way we market to consumers. We're transforming the way we deploy our network. And you've seen, I mean, we've done a lot of different areas that have allowed us not only to take cost out, but to take cost out on a run-rate basis, which is hard. This will continue. We have a very aggressive transformation numbers to hit in 2016, that I think the team had been doing a really good job. But 2017 will not be anything different. We have very aggressive goals in order to continue to lower our OpEx. We've already know exactly where we need to be. It's a substantial number, very similar to the previous two years, and we have that in 2018 and we have that in 2019. So like I said, we have a five-year plan that pretty much will put OpEx at Sprint from being the highest carrier with the highest OpEx as a percentage of revenue, to actually taking us to be the lowest carrier, with the lowest cost, as a percentage of revenue.

I mean, the reason why we are so focused on this area is we have a Chairman that that's exactly what he did in SoftBank. So I can tell you that those weekly transformation calls, in which we go line item by line item in our P&L, are going to continue until we execute our five-year plan.

John Christopher Hodulik
Analyst, UBS Securities LLC

Q

Great. Thanks, Marcelo.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Thank you.

Operator: Our next question comes from Matthew Niknam with Deutsche Bank.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys, thank you for taking the questions. Just one big picture, one, on strategic positioning. Given the industry's shift to mobile, some of the cable and wireline players have a stated desire to have a bigger presence in wireless. How do you think about your 2.5 gigahertz spectrum position as a potential resource for strategic partners? And then, secondly, do you think Sprint needs more scale with a content partner, or working more closely with content partners, to better differentiate Sprint long-term? Thanks.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

It's been a busy last four or five days, as everybody suddenly has a point of view as it relates to what happened to the industry. I would say that our strategic value to many has significantly grown, as we've had a lot of bankers placing more calls than usual over the weekend, which is definitely quite interesting because of what is going on in our industry. Now, I think the transaction that you are referring to, I think it validates the point of content providers and wireless carriers can go hand in hand. It's happening in other parts of the world. Now, we look at it, we're very confident that the U.S. regulatory system is going to work and is going to make sure what we want is that relevant content never be exclusive to one company, and that relevant content will be available to all carriers, or that the regulatory system will not allow any type of other discriminatory pricing. And to us, it's definitely a plus. The fact that there is going to be great content in moving to mobile, and we're building a network that is – it's being built for [ph] that (44:28). It's being built with the capacity that you need to transport content at pretty fast speeds with a tremendous amount of capacity.

So, again, there's a lot more runway in terms of what's going to happen to the industry. But, definitely, when you're sitting on the spectrum that we're sitting or that we're utilizing, I think this validates the point that the more spectrum that you have, you will have more capacity. And as viewership of content has dramatically changed to mobile, I think we're in a great position for the future, in order for us to be able to provide content to our customers.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

And just one quick follow-up on free cash flow or adjusted free cash flow, you're already north of $1 billion for the fiscal year-to-date. What's driving the expectation to stay around break-even for the full year?

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

I'm going to let Tarek answer that question.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

Yeah, good morning, and thank you for asking the question. You're right. Our adjusted free cash flow was $707 million, compared to negative $100 million last year. This was driven in the quarter by lower network CapEx, and also expense reductions that were re-deposited to that metric. But we are guiding for CapEx to be less than $3 billion in fiscal year 2016. And as you can see also in the first half, our CapEx has been a lot less than what we expected to be in the second half. And that's why we expect overall, once CapEx catches up in our fiscal year 2016, to get back to adjusted free cash flow break-even.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. Thank you.

Operator: Our next question is from Amir Rozwadowski with Barclays Capital.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thank you very much, and good morning, folks. I was wondering if we could just follow-up on that prior question around CapEx trajectory going into the remainder of this calendar year and heading into 2017. Any thought process on how we should think about the trajectory of CapEx going forward with respect to the business, as you focus on ongoing initiatives to densify the network?

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

Yeah, Amir, thank you for asking the question. So, first of all, let me recap what my colleague, John Saw, said a moment ago. In the prior years, we have, as Sprint, invested more CapEx per user than many other carriers in the United States. So we're reaping the benefits of that prior historic investment. This year is a year where we're going through the permitting to enable our densification and optimization strategy. As the permits come in, and we are pleased with the progress that has been accomplished so far, our CapEx will ramp-up in the second half of fiscal year 2016. The roll-out of our network will probably be accelerating in fiscal year 2017. It's too early to guide you on CapEx on fiscal year 2017, but suffice it to say that you can expect an acceleration of CapEx spend on fiscal year 2017 relative to fiscal year 2016.

In saying so, it's also very important to understand that, when you have a carrier that has such a large spectrum holding, there is a natural equilibrium between the amount of CapEx that is going to be spent and the spectrum holdings that the carrier has. We are in an enviable position with the best spectrum that is catering, as Marcelo said, to building a high capacity data network for the future, as we see data traffic on wireless networks doubling every 18 months. And that is why we are well-equipped to cater for that trend, is because of our spectrum holdings.

So longer term, yes, we will have to spend more on CapEx, but, overall, thanks to our spectrum holding, we will have a capital intensity and capacity advantage relative to other players in this industry.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

That's very helpful. And then, if I may, one quick follow-up. I realize you can't talk about the current lease-backed financing structure, but what is your thought process on the need for further capital raises? It does seem as though there is an advantage to driving down your cost of debt going forward. But would love to hear your thought process around potential future financing needs.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

So it's very important, from a financing strategy standpoint, that, as a company, we have access to diversified sources of financing. When I first joined Sprint, the mantra, historically, has been to raise money by a way of high yield debt issuances. I think that's fair, but now we are in a different position and our strategy has been to actually diversify our sources of funding. We think that Spectrum LeaseCo has set a new benchmark. And when you look at the cost of debt of 3.36% relative to our average interest expense, and if you just look at the debt we're going to retire between the December 2016 maturities and the March 2017 maturities, plus the Clearwire notes, clearly, as Marcelo said, Spectrum LeaseCo will be accretive from an interest expense reduction standpoint. You can just do the math yourself. You'll see we're saving about $140 million of interest expense per year.

So moving forward, our intention is to bring down the interest expense as quickly as possible so that we can get to a point where we are pre-tax positive, given that we have a fair amount of cumulative operating losses, $19 billion – in excess of $19 billion of cumulative operating losses that we would like to utilize.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Excellent. Thank you very much for the incremental color.

Operator: Our next question comes from Michael Rollins with Citigroup Investment Research.

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

Q

Great. Thanks. A couple questions, if I could. The first, if you look at the postpaid revenue line, can you unpack that for us in terms of what part of that is the access versus the mix of other things you sell, whether it's the overage, whether it's the insurance or other features? And what's the ability to change that over time, as you mention that you're putting the group on the opportunity to raise – build revenue per customer over time?

And then secondly, you mentioned that you're going to start getting more devices back from leases, and I was wondering if you could just walk us through, at a high level, how to think about the financial impacts over the next 12 months to 24 months that is created as these devices start to come back to you. Thanks.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

Thanks, Michael. First of all, I don't have that in front of me, and secondly, we don't disclose what part of the business is contributing what as it relates to our ARPU and our ABPU. What I can tell you is that we're committed to growing our average billing per user. We have a lot of different levers to pull, like I said, lease – I mean, internally, we call it lease monetization, which is basically we are getting phones back from leasing at a residual value that, in many cases, is significantly lower than the market value of those devices. That was contemplated when we launched leasing, so the leasing story is playing out exactly how we had anticipated. And there's a lot more that we can do to optimize the base. Quite frankly – traditionally, we haven't put a lot of attention to this and now we're looking at how can we make sure that we can optimize the profitability down to the subscriber level. We're putting a lot more attention into selling our customers insurance, selling them more accessories, selling them value-added services and making sure that the rate plan is optimized. We have a lot of opportunity ahead of us. I will say this, one of the largest opportunities due to the fact, like I said before, when you've loaded so many customers at a 50% off discount and that discount expires, there's a good opportunity in order for us to be able to increase the amount of money we're collecting from a customer, which is actually, I would say, one of the best sources of profitability because you don't need to invest any more money in terms of subsidies or in terms of capturing the customers, monetizing the base that we have. So, a lot of ideas, a lot of projects, lots to do in the execution side. But we have a lot of good levers to pull.

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

Q

Thanks. And on the leased devices, the return and how that looks financially for you over the next 12 months to 24 months?

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

We expect that to be – like I said, we expect that to be positive. You can do your own math in terms of how much the customer is paying on a lease, what the residual value when it comes back and the fair market value today is greater than the residual value that we have when we're getting these devices back on a grand majority. So, that's an area that we're going to put at focus and that's an area that's going to help enhance Sprint's profitability in the next 12 months to 18 months.

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

Q

Thank you.

Operator: Our next question is from Colby Synesael with Cowen & Co.

Colby Synesael
Analyst, Cowen & Co. LLC

Q

Great. Thank you. Just wanted to go back to the question I think Hodulik may have asked around the prepaid strategy. I know that that's something that you guys have been talking about for a little while, particularly around some of the brands, about what you're going to do to improve that. I was wondering if you can give us a little bit more color on when we could actually expect to see that lift. And then also, your Wireline business, I know it doesn't get much attention, but we continue to see that going down in terms of revenue every single quarter. Is there a point where you should think about monetizing that or are you just going to let that continue to attrite? Thank you.

R. Marcelo Claure
President, Chief Executive Officer & Director, Sprint Corp.

A

So I'll take prepaid and then I'll let Tarek does Wireline since he's been helping me manage the Wireline business. As it relates to prepaid, I think the best way to look at it is we're managing our prepaid business for profitability. It is the level of competitiveness in that market, it's darn pretty crazy. I mean, our competitors are giving away a free device with tremendous amount of subsidy to a customer that has no contractual obligation to stay. So you can get a subsidy in the $100, $150 range, walk in and cancel the contract tomorrow or grab those phones and sell it overseas. We saw that. We lived that. If you remember, one and a half years ago, we basically grew our prepaid business where we were the fastest growing and the leading one. It all comes back to catch you later on, because you can only disguise tremendous amount of gross adds and disguise the number of the activations or false activations that happens in the system. We're not in a position to play that game. Right? We're in the middle of a turnaround, so we're managing our business smartly and we're managing our business for profitability.

We are doing a lot of different things. So you're going to see customer losses that really have no impact. It's basically what we're doing is, we're changing our churn rules to bringing them forward. So all of them have the same churn rules, so we can run our business a lot more effectively. Boost continues to perform extremely well in the market. As you can see, we had a large amount of gross adds. We are re-launching Virgin. We expect to do that in the next couple of quarters. We have done a joint venture for our Assurance or Lifeline business. That should be executed very soon. And we're partnering with Kroger, who we believe has a tremendous asset to enhance our distribution strategy.

Again, we're committed to being in prepaid. But where we're not committed is to basically competing away with just an unprofitable way to track customers. So we will continue to have a good, solid prepaid business. Again, managing the business for profitability as, like I said, Sprint's turnaround story. We have a five-year plan, and we're not going to get into competitive wars on prepaid. There's really [ph] no side (57:34) in terms of when you give away a phone for free with no contract to consumers. As it relates to Wireline, I'll pass it on to Tarek.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

All right. When you look at our Wireline business, it's a very important asset to Sprint. First of all, it's a Tier-1 ISP, and there are not many of them worldwide. It's one of 12. It's a very important asset in the context where wireless data traffic continues to grow exponentially, and it's also an asset who is undergoing a transformation in its own right. Some of the financial performance of our Wireline business, particularly of the top-line, is related to the decline of legacy revenue, which is very low margin. And what we have being doing in the Wireline business is to transform that legacy voice hubbing low margin revenue, and move away from it, and expanding to value-added services that are higher gross margin whilst, at the same time, taking cost out from all the legacy [ph] links (58:38) that are very expensive for us to resell.

So, Wireline will transform itself. It's a very important asset for us. What you have to take away, for the moment, is that this is a gross margin story as we change the composition of the revenue towards more profitable revenues in the future.

Colby Synesael
Analyst, Cowen & Co. LLC

Q

And I guess once you've made that transition, should we anticipate a greater investment, be it in distribution or perhaps some bolt-ons of your own, to kind of enhance that?

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

I think when we look at our Wireline business, there's a lot of capacity in there already. What we have to do is to just fill that capacity with new services that generate new revenue for us. And so, you can expect that we will make a push into it. It's a strategic asset for Sprint, particularly for our enterprise customers, and we want to see that asset grow.

Colby Synesael
Analyst, Cowen & Co. LLC

Q

Thank you.

Jud Henry
Vice President & Head of Investor Relations, Sprint Corp.

Thank you, Colby. 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 any additional questions following the call, please contact the Sprint Investor Relations team.

Marcelo?

R. Marcelo Claure

President, Chief Executive Officer & Director, Sprint Corp.

Thank you. I want to thank everyone for joining us today and for your support of Sprint. I see this as a very important quarter in our turnaround as we grew our consolidate and net operating revenue year-over-year for the first time in over two years. Meanwhile, we remain disciplined and we will continue to be disciplined in our cost transformation efforts, with over $1.1 billion of year-to-date reduction in cost of services and SG&A. We continue to be postpaid net port positive against all three national competitors, and we've doubled our postpaid phone net additions from last quarter as a result of growing our share of postpaid phone gross adds and delivering the lowest postpaid churn in Sprint's history. We're very confident that our densification and optimization strategy of the network is going to unlock the value of our spectrum holdings, and we're going to continue to provide customers the best experience, and we believe that Sprint will be best positioned of all the carriers for the growing data demands of consumers in the future. Altogether, we continue to move forward in our transformation in the second quarter, and I look forward to sharing further progress with you next quarter.

Thank you and have a great day.

Operator: This concludes today's conference call. You may now disconnect.