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Sprint Corp. (S)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for standing by. Welcome to the Sprint Fiscal Third 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 conference 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 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's Investor Relations website at www.sprint.com/investors.

Slide 2 is our cautionary statement. I want to point out that in the remarks this morning, we will be discussing forward-looking information which involves a number of risks and uncertainties that may cause actual results to differ materially from our forward-looking statements. We provide a comprehensive list of risk factors in our SEC filings which I encourage you to review.

Throughout our call, we will refer to several non-GAAP metrics as shown on slide 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.

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

Raul Marcelo Claure

President, Chief Executive Officer & Director, Sprint Corp.

Thank you, Jud, and good morning, everyone. The third quarter was very important as we demonstrated that we continued to gain traction in our turnaround even in a very competitive environment. We grew net operating revenue year-over-year for the second consecutive quarter while continuing to reduce our cash operating expenses. This drove a more than $500 million improvement year-over-year in both operating income and adjusted EBITDA.

Our postpaid phone net additions were the highest in four years and improved year-over-year for the ninth consecutive quarter. We had over $9 billion of liquidity at the end of the quarter and issued $3.5 billion of spectrum-backed note on an interest rate of 3.36%, which was less than half of the rate of our previous bond issuance. In addition, our network continues to reach new levels of best-ever performance as shown by many third parties recognizing the quality of our network.

Turning to slide 5, our customer growth continued in the third quarter with 577,000 total net additions for the quarter. Postpaid net additions for the quarter were 405,000. This growth was almost entirely from the highest profit contribution category for business, as our postpaid phone net adds were the highest in four years with 368,000, which approved year-over-year for the ninth consecutive quarter. This brings our year-to-date total to 888,000 phone net adds and that's already more than double our phone net additions in the full year last year.

Our competitors threw a lot of aggressive promotions this quarter, and yet we continued to grow our share of industry postpaid phones, giving me even more confidence in the strength of our brand. Our postpaid phone gross additions were the highest in four years and up 5% year-over-year. Moreover, we have now surpassed Verizon for four consecutive quarters in postpaid phone net additions as we delivered 200,000 more than them this quarter. And we surpassed AT&T for the ninth consecutive quarter and by 500,000 this quarter.

Postpaid phone churn was up slightly year-over-year at 1.57% as a result of the competitive intensity with a flurry of free and discounted devices and switching offers. In addition, some of the churn impact is from actions that we took related to help customers buy devices. We removed subsidy as an option in national retail which caused some customers looking to upgrade on subsidy to jump to competitors that continue to offer it.

We also had customers rolling off their original iPhone for Life leases at $20 a month and choosing not to step up to iPhone Forever program at $27 a month. [indiscernible] (04:07) changes to device purchase options, we believe our churn would have continued to show year-over-year improvement this quarter. And while we would like to please every customer, these were the right decisions to simplify our business and continuously improve the economics of providing devices to our customers. The good news is that we expect churn to improve roughly 5 basis points sequentially in the fourth quarter and return to year-over-year improvement compared to sequential increase last year in fourth quarter.

Prepaid net losses in the quarter were 501,000 driven by continued competitive intensity in the prepaid space, as well as the impacts of repositioning some of our prepaid brands this year. In addition, we removed approximately 1.2 million prepaid customers from our base as a result of aligning our churn rules and eliminating legacy retention programs that we foreshadowed to you last quarter. However, we have begun implementing a number of changes within our prepaid brands, and I'm encouraged by the early results as Boost had positive net adds in the month of December. Lastly, our wholesale and affiliate business continue to grow with net addition of 673,000.

Now let me update you on our progress on the network on slide 6. Our network continues to improve and perform at best-ever levels and we're delivering on our goal of unlocking the value for spectrum holding by densifying and optimizing our network to provide customers the best experience. Customers continue to say that network reliability and consistently high voice quality are what matters most to them and that's where Sprint's network continues to shine. Data from Nielsen show that Sprint network reliability has continued to narrow the gap to best-in-class and remains within less than 1% of AT&T and Verizon.

Also, independent mobile analytics firm, RootMetrics, recently completed their testing of the top 125 metros across the country for the second half of 2016. I'm proud to report that Sprint won the most metro RootScore award in the company's history, and we increased the number of awards by nearly 50% in the second half of 2016 compared to the first half of this year, showing the real-time progress that we're making. Another milestone achievement from the RootMetrics testing is that Sprint surpassed Verizon for the most [ph] voice calls (06:08) RootScore awards of any carrier.

I mentioned previously J.D. Power, the leader in independent industry benchmarking studies, now ranks Sprint second for wireless network quality performance in five out of six geographic regions of the U.S. in its 2016 Wireless Network Quality Performance Study. Lastly, in December, the editors of Computerworld reporting in their annual customer satisfaction survey that Sprint was the most improved with customer satisfaction with their Sprint data connection up 21%, satisfaction with reliability of data connection up 26%, and a Sprint tied for satisfaction with upload speed improving 18% year-over-year.

Turning to slide 7, we remained focused on densification and optimization strategy to deliver a great network in the future by unlocking the power and value for spectrum. We continue to use a number of tools to densify and optimize our network. We mentioned previously that we have deployed 200 small cells in Manhattan and, as a result, have seen average download speed double across the city.

To prepare for the Super Bowl in Houston this weekend, we installed more than 100 small cells in and around NRG Stadium, another popular location. We also benefit from the fact that 2.5 GHz represent one of the largest LTE ecosystems in the world with fellow operators in China, Japan, and recently, India. This drives the rapid evolution of technologies in both network and devices, and thus, technology scale [indiscernible] (07:31) very quickly due to the sheer size of the ecosystem.

LTE Plus is now available in over 250 markets in the U.S. and I'm proud of our network team for having the foresight two-plus years ago to deploy 8T8R radios as part of the 2.5 GHz rollout which is the enabler of beamforming providing stronger signal delivery for better [indiscernible] (07:49) performance. In addition, Sprint has already deployed three-channel carrier aggregation in over 100 markets, which is expected to provide big download speeds of more than 200 megabits per second on capable devices. We recently delivered software updates to enable 3CA aggregation capabilities to six devices including the recently-launched iPhone 7 and Samsung Galaxy S7 in addition to the HTC Bolt that was enabled at launch.

The best part of our carrier aggregation deployment is how seamless it is thanks to the fact that we utilize radios and antenna capable of multiple carriers when we originally deployed our 2.5 GHz and, as a result, generally do not need to go back to the tower each time that we light up another 20 megahertz channel of our 2.5 GHz.

We're excited about bringing more technology innovations to market. Sprint recently unveiled High Performance User Equipment, or HPUE, a breakthrough innovation designed to optimize the 2.5 gigahertz network coverage and further unlock our spectrum advantage to give Sprint customers with capable devices better coverage and faster data speeds in more locations. [ph] This brand new (08:52) technology is capable of extending the 2.5 gigahertz coverage by up to 30% to nearly match our 1.9 gigahertz spectrum performance, including indoors where the majority of wireless traffic is generated.

We expect to begin rolling out HPUE devices in the next few months from several of our device OEMS. Furthermore, we look forward to beginning field testing of massive MIMO on our 2.5 gigahertz spectrum that will enable us to deliver gigabit per second speeds. What's unique to Sprint and 2.5 GHz is that massive MIMO is impractical on most other bands held by carriers today due to the sheer size of antennas and especially lower bands. Generally, the lower the spectrum band, the bigger the antenna and vice versa, which is a strategic advantage to Sprint by greatly expanding the potential structure and locations where we can deploy these smaller antennas. We believe that a 2.5 spectrum is well-suited as a sub 6 gigahertz band for 5G as well given the very wide channels and the fact that it is TDD, which is a leading candidate for 5G as well.

Moving to slide 8, we continued to build our brand and value proposition on the back of our improved network. We have been very pleased with the consumer adoption of Unlimited Freedom, giving customers value and simplicity with a simple and a straightforward plan coupled with Sprint's reliable network. With the capacity and reliability of our LTE Plus network and our deep spectrum position uniquely positioned to deliver data traffic, we're able to dramatically simplify our rate plans and give customers the peace of mind to not think about their data plans anymore.

Last week, we announced acquisition of a minority stake in TIDAL as a Sprint entry into the content space with an exclusive partnership, and I couldn't be more excited to bring Sprint's 45 million retail customers unlimited access to exclusive artist content not available anywhere else. There's a hypothesis in the industry that content is an important differentiator in wireless, and this allows us to test the effect of exclusive content on customer acquisition and retention without us spending billions like our bigger competitors. Digital consumption of music has overtaken physical forms and TIDAL's artist owners, exclusives, and focus on videos and events will help to differentiate it from the competition.

Our brand continues to gain momentum as well, as shown recently by YouGov, who talks to millions of consumers to track what they think of different brands. Based on YouGov's BrandIndex, our brand is up 67% since September, and the tremendous improvement of our brand is another sign showing just how much our hard work is paying off. YouGov said that our Paul campaign along with Unlimited Freedom plans made a difference in turning around the way people think about Sprint. Speaking of our Paul campaign, we were proud to see that Wall Street Journal recognized our Paul campaign as the best ad of 2016.

Lastly, we're celebrating the one-year anniversary of our transition to a regional sales model, and we saw greatest strides in the first year under the new model. Our sales conversion rating company on retail stores increased by over 25% year-over-year in 2016. And with the team hitting their stride, we look to further improve our sales productivity in 2017.

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

Tarek A. Robbiati, M.B.A., M.Sc.

Chief Financial Officer, Sprint Corp.

Thank you, Marcelo. Moving to revenue on slide 9, consolidated net operating revenues were over $8.5 billion for the quarter, growing over 5% year-over-year, which is the second consecutive quarter of year-over-year growth. Meanwhile, our Wireless net operating revenues of $8.2 billion grew nearly 7% year-over-year.

Wireless services revenue of just under $6 billion remained relatively stable sequentially, and the 4.8% year-over-year decline was the lowest year-over-year decline in the last two-and-a-half years. Postpaid service revenue is down only 2.6% year-over-year, as we continue to transition the mix of customers in the postpaid base now on rate plans offered in conjunction with device-enhancing programs. In addition, I want to mention that Sprint changed the terms of its vendor agreement for our service and repair program at the beginning of January, which is expected to result in net savings to the income statement.

However, under the terms of the new agreement, Sprint expects to only book the net margin from the program as revenue and no associated costs compared to the prior program where we booked the gross revenue from customers as revenue and the associated expenses in costs of services. As a result, we expect our reported service revenue will be lower by approximately $200 million per quarter and would expect an even greater reduction in the associated expenses. As a result, this is expected to be accretive to adjusted EBITDA by roughly $25 million to $50 million per quarter.

Postpaid average total billings per account was up over 2% year-over-year to $171.28 for the quarter as we are seeing an increased number of phones per account. Postpaid phone average billings per user of $71.77 for the quarter increased over 1% year-over-year. As a result of the change in recognition for service and repair revenues, we expect postpaid phone ARPU to decline by roughly $2.50 and the total postpaid ARPU to decline by $2 in the fourth quarter, but we continue to focus on maintaining and growing the core monthly services revenues from our customers.

80% of postpaid device sales in the quarter were financed, which includes 84% of postpaid phone sales being financed. At the end of quarter, we had 71% of our postpaid phone base on unsubsidized rate plans. This leaves only about 20% of our postpaid phone base to be transitioned unsubsidized rate plans, if we assume that over the intermediate term we will not likely exceed 90% penetration due to business in other legacy plans.

Prepaid ARPU in the quarter of $27.61 increased by 1% year-over-year. As Marcelo mentioned earlier, we did remove approximately 1.2 billion low-engagement customers from our prepaid base. However, because the change happened late in the quarter, it did not materially impact ARPU in the quarter. Looking forward, we would expect prepaid ARPU to be approximately $2.50 higher as a result of this change.

Regarding our operating expenses on slide 10, we continued to execute on our cost transformation in the quarter. We realized over $470 million in net reductions in operating expenses year-over-year in the third quarter across cost of services and selling, general, and administrative expenses. This brings our year-to-date expense reductions to over $1.6 billion.

Cost of services for the quarter of the $1.9 billion was down for $423 million year-over-year primarily driven by lower labor expenses associated with the renegotiated Ericsson agreement, lower roaming and backhaul expenses, and the shutdown of the WiMAX network. Selling, general, and administrative expenses were $2.1 billion in the quarter and improved by $49 million from year ago, mostly driven by lower sales and customer care expenses.

Cost of products of $2 billion for the third quarter increased by $396 million from a year ago, mostly driven by the significant increase in the installment billing mix of sales from the prior year. We continue to have good momentum in our cost transformation as we head into the final quarter of 2016 and we are already developing initiatives for additional expense reductions in 2017 and beyond.

Now turning to slide 11, our adjusted EBITDA of $2.5 billion for the quarter improved by over $500 million compared to $1.9 billion a year ago with the improvement primarily driven by the expense reductions that I discussed as well as growing operating revenues. Operating income of $311 million for the quarter also improved by over $500 million when compared to an operating loss of $197 million a year ago. We have now reported positive operating income for four consecutive quarters and have delivered $1.3 billion of operating income year-to-date.

Sprint's net loss for the quarter was $479 million, or $0.12 per share, compared to a net loss of $836 million, or $0.21 per share, in the year-ago period. The current quarter included $47 million primarily related to asset dispositions and severance costs and $74 million related to other expenses incurred from the early termination of the $2.5 billion unsecured financing facility upon closing of the spectrum-backed notes. The prior year was impacted by $209 million of severance and exit costs. Adjusting for these items, our net loss improved by approximately $269 million year-over-year, or approximately $0.07 per share.

Turning to slide 12, cash capital expenditures were $1.2 billion in the quarter compared to $1.6 billion in the year-ago period with a year-over-year decline driven by lower capital spending on the network as a result of software-driven deployments of capacity through carrier aggregation and surgical deployments of small cells.

This quarter also included $477 million within these CapEx related to the repurchase of devices in the first tranche of MLS. While Sprint is uniquely positioned to operate in a lower capital intensity as a result of our tri-band LTE network foundation and our deep spectrum position, we do expect CapEx to accelerate in the fourth quarter and into fiscal 2017 as part of our densification program.

Net cash provided by operating activities was $650 million for the quarter compared to $806 million in the year-ago period. Adjusted free cash flow, which includes all the net cash flows associated with devices, was negative $646 million for the quarter compared to a positive $339 million a year ago. The prior-year quarter included $1.1 billion of proceeds from the first sale lease-back transaction with Mobile Leasing Solutions, or MLS, while this quarter included a net cash outflow of approximately $370 million related to the repurchase of devices in conjunction with the termination of our MLS Tranche 1 agreement.

Shifting focus to liquidity on slide 13, we ended the quarter with a total generated purpose liquidity of $9.1 billion including $6.1 billion of cash, cash equivalents, and short-term investments. In addition, we still have $1.2 billion in undrawn availability under our network vendor financing facilities that can be used to finance the purchases of 2.5 gigahertz network equipment.

During the quarter we raised $3.5 billion of spectrum-backed senior secured notes in an innovative transaction that represents the latest example of our strategy to diversify our sources of financing in order to lower our cost of capital and future interest expense. The notes priced at 3.36% which is materially less than the coupon on the maturities that we paid in December including $2 billion of 6% notes and $300 million of 14.75% Clearwire notes.

We are also opportunistic in terminating the first MLS tranche early, as I mentioned a moment ago, and we look forward to paying the [ph] milestones (20:00) coming due with a 9.125% coupon which is nearly 3 times higher than the rates on our spectrum notes. Furthermore, we continued to strengthen our balance sheet and lower our cost of capital and we are in the process of refinancing our revolving credit facility. We expect to enter into a secured revolving credit facility, as well as a Term Loan B and will provide further updates upon the closing of these transactions.

Lastly, I was happy to see Moody's recently recognize the tremendous progress we have made not only operationally but also in the way we are financing the business and upgrading our debt ratings as a result of their confidence in our transformation.

Now, let's look at fiscal year 2016 guidance on slide 14. As we near the end of our fiscal year, we're tightening our guidance range at the high end of our previous guidance of adjusted EBITDA to be $9.5 billion to $10 billion and expect to finish the year between $9.7 billion to $10 billion. Similarly, we're narrowing our guidance for operating income towards the high end of our previous range of $1.2 billion to $1.7 million to now expect $1.4 billion to $1.7 billion in fiscal year 2016.

Regarding our guidance for cash capital expenditures excluding leased devices, we now expect to spend between $2 billion and $2.3 billion, given better visibility into the timing of cash payments related to the densification. We continue to expect to further ramp up our densification and utilize the expanded toolbox of various cost efficient coverage and capacity options in the fourth quarter of fiscal year 2016 and into fiscal year 2017. Lastly, we continue to expect adjusted free cash flow in fiscal 2016 to be around breakeven.

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

Jud Henry

Vice President & Head of Investor Relations, Sprint Corp.

Thanks, Tarek. In just a moment, we will begin the Q&A. Angel, 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 Brett Feldman with Goldman Sachs. Please go ahead, sir.

Brett Feldman
Analyst, Goldman Sachs & Co.

Q

Thanks. I just want to ask a couple of questions about the liquidity discussion that we had there. So, first of all, I looked at your adjusted free cash flow guidance which you're maintaining around breakeven. It looks like you'd be using cash in the fiscal fourth quarter, typically [ph] that's a period (22:33) when you would generate it. So, I was hoping we can get a little more color on what drives that. And then I'm curious, are you going to continue using MLS at all going forward now that you've put some other financing measures in place and does that still seem like an attractive way to help finance your device business? Thanks.

Tarek A. Robbiati, M.B.A., M.Sc.
Chief Financial Officer, Sprint Corp.

A

Good morning, Brett. This is Tarek speaking. Yes, let me just give you a little bit more color on adjusted free cash flow in the quarter and our outlook for this fiscal year 2016. The adjusted free cash flow for the quarter was negative $646 billion compared to a positive $339 million last year. You probably remember then that in fiscal year 2015 in the third quarter, we had an inflow of $1.1 billion of cash related to the sales proceeds from MLS-1, whilst in this third quarter of fiscal year 2016, we chose to pay and repurchase the MLS-1 devices early, which triggered an outflow of $317 million. So, when you normalize for those puts and takes, excluding the MLS-1 transaction, our adjusted free cash flow would have improved by about $500 million year-over-year, mostly due to lower network CapEx and also the cost reductions we have realized.

Now, when you look at our guidance for fiscal year 2016, we continue to say that we expect adjusted free cash flow to be around breakeven. This reflects also the fact that we are reducing our CapEx guidance from less than $3 billion to $2 billion to $2.3 billion. There could be a little bit of upside on our adjusted free cash flow guidance, but for the moment, we're pretty happy with where we are. Our goal at the beginning of this fiscal year was to attain adjusted free cash flow breakeven and we continue to maintain that goal.

Brett Feldman
Analyst, Goldman Sachs & Co.

Q

And then in terms of thinking about how you finance your devices going forward, since you paid down the first tranche in MLS, do you still intend to use that as a financing source or do you feel like your other financing sources are more attractive right now?

Tarek A. Robbiati, M.B.A., M.Sc.
Chief Financial Officer, Sprint Corp.

A

Yeah. I mean, a year ago, in November 2015, the markets were in a very different condition than they are today, and our access to those markets was very, very different. MLS structures, MLS-1 and MLS-2, have helped us greatly get a significant injection of cash at a reasonable cost relative to what we would have done with alternatives back in the third quarter of fiscal year 2015.

We always said that we would have the MLS structures [ph] evolve (25:19) and our strategy is to diversify our sources of funding in order to lower our cost of capital and future interest expense. Most likely, we will no longer use MLS as a structure, although we may come back to it, but we see different structures that we can use to continue to lower our cost of capital moving forward, especially now that we have raised a spectrum lease at a coupon of 3.36%.

Brett Feldman
Analyst, Goldman Sachs & Co.

Q

Great. Thanks for that color.

Operator: And your next question comes from the line of Amir Rozwadowski with Barclays. Please go ahead, sir.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thanks very much. Two questions, if I may. You folks have been successful at executing on your cost-reduction initiatives. Can you provide some color on the potential size and scope of further reductions going forward? It seems as though many of the initiatives for the next leg of your cost reductions, whether it's the stuff you guys have been doing around billing or the replacement of the network management contracts you had in place, are really just rolling out. So, I wanted to see if there is some color you can provide in terms of the potential size and scope of these reductions going forward.

Tarek A. Robbiati, M.B.A., M.Sc.
Chief Financial Officer, Sprint Corp.

A

Yeah. I mean, we achieved already over $1.6 billion of cost reductions year-to-date in cost of service and selling, general, and admin expenses. We are on track and continue to expect at least $2 billion of run rate OpEx reductions exiting fiscal year 2016 into fiscal year 2017. We do expect further cost reduction in 2017 but, at this stage, we're not providing an exact dollar amount. We will do so as we will provide guidance for fiscal year 2017.

Suffice it to say that our transformation program and cost reduction program is not a one-year matter; it's a multiyear program, and the areas for future cost reduction will include optimizing the channel mix in our distribution, improving our digital experience so that customers can transact more online, we will continue to optimize backhaul and reduce cost per bit, et cetera, et cetera. So you'll see more of the same across the two major cost strategies of cost of services and selling and general and admin expenses in fiscal year 2017.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thanks very much. And then I was wondering if we may discuss how you view your position in the market on a bigger picture framework. Clearly, there have been lots of discussions about various combinations and permutations, so I would be remiss if I don't ask you your thought process around Sprint's opportunity inorganically drive scale. Within that context, do you believe that given what we are seeing from an evolution of the market, is that necessary and do you think that your opportunities have changed since just a couple of years ago?

Tarek A. Robbiati, M.B.A., M.Sc.
Chief Financial Officer, Sprint Corp.

A

So we are, first and foremost, focused on maximizing value for our shareholders on a stand-alone basis by executing our transformation plan. There is external speculation on potential strategic opportunities, and there could be potential synergies with different types of transactions and any other models that are currently being discussed.

The common thread is that Sprint has great assets including the best spectrum portfolio in the U.S. And to maximize the synergies in any theoretical or strategic opportunity, these assets will be the key component for 5G and for delivering content moving forward. From a policy perspective, it would seem to make sense that over the long term, further consolidation among the smaller players may be necessary to compete with the big two, but it's early days and we will monitor that situation closely.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thank you very much for the incremental color.

Operator: And your next question comes from the line of John Hodulik with UBS. Please go ahead.

John Christopher Hodulik
Analyst, UBS Securities LLC

Q

Okay. Thanks. Marcelo, you've talked about how competitive the market was in the calendar fourth quarter. Can you talk about how that's evolved as you look out into the first quarter? There's been a number of pricing changes and we'd like to get your opinion on that. And then along with that, do you expect the improvements in the postpaid phone adds to continue as we look out into calendar 2017? And then just lastly, prepaid's really been the soft spot. You've made a lot of improvement in terms of postpaid revenues. Prepaid is a different story. Talk a little bit about your sort of plans to change that and whether the – I guess the Boost trends you cited in December can continue as well. Thanks.

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

A

Thanks. Since most of you follow the industry quite closely, you've probably saw the fourth quarter – or the calendar fourth quarter was highly competitive. As a matter of fact, like I said it was the most competitive I have ever seen since I became CEO of Sprint. I mean T-Mobile was so aggressive that they jumped out a week before Black Friday and carried a $800 credit. Verizon had a [indiscernible] (30:12) and switcher offers all quarter. I mean, you could go to Best Buy and, in some cases, get over $1,200 for switching.

And if you notice what we did is we were the only carrier that did not offer a free iPhone for Black [ph] 7 (30:24) Friday. So, where put a lot of our attention was in how can we increase the number of line accounts that we could have. So, that's why you saw us be very aggressive in the three, four, five line accounts, which is where most of AT&T and Verizon families reside.

So, it was competitive, but at the same time, I think this was the best quarter so far that we've had from a performance basis. We measured our share of gross adds for the quarter, and we were up all the way close to 20%, which was up 170 basis points and it was up slightly quarter-over-quarter.

So, when I look at this quarter overall, I saw that it was the most competitive quarter in which our competitors were the most aggressive and we were still able to beat AT&T and beat Verizon. So, we like what happened last quarter.

When you roll into this quarter, I think things have slowed down a little bit as it relates to competition. We've also tone it down, and you've seen that we're a lot less competitive. And we continue to – we believe that we can continue to execute the same way and be able to continue to attract the same level of customers that we have.

When you look at last quarter, it was the best quarter in terms of gross adds in the last four years, which then means that our marketing, our brand is getting better and more customers are coming to Sprint. So, we expect this quarter to be obviously a lot less than last quarter because it's not the holiday season, but we expect the quarter to continue with the same trends.

As it relates to prepaid, it's hard to fight at two fronts at the same time while you're trying to grow revenue, take cost out. So, I will say our prepaid business, we had decided not to be so aggressive and mainly run it last year for profitability. Things have changed this year. We're committed to basically utilize both of our brands. Boost has had a – we started getting aggressive and competing hard in December, and it was the first month in which we were positive in December as a result of our pricing changes and our distribution changes.

That hasn't changed. We expect this quarter to be the same, and we expect Boost to [indiscernible] (32:36) aggressively on the market going forward. And as it relates to Virgin, we envision Virgin as a disruptive brand. We plan to introduce some different ways in which you go to market selling prepaid. And that is – so you can expect us to start doing different things with Virgin in the next couple of months. So full on on prepaid, we like our positioning and we expect our prepaid business to start behaving like our postpaid business starting this quarter.

John Christopher Hodulik
Analyst, UBS Securities LLC

Q

Got you. Thanks, Marcelo.

Operator: And your next question comes from the line of Jennifer Fritzsche with Wells Fargo. Please go ahead.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you. Two if I may. Could you talk a little bit about – Tarek, for you, the cost of capital clearly has come down for you. What are your thoughts about going back to the high-yield market? And then secondly, if you could, I don't know if Dr. Saw is on, but if you could talk a little bit about the HPUE initiatives, remind everyone on the timing of that and, I guess, in a simple way, what that can bring to your network. Thanks.

Tarek A. Robbiati, M.B.A., M.Sc.
Chief Financial Officer, Sprint Corp.

A

Good morning, Jennifer. So, I'll take the question on cost of capital and hand over to my colleagues, John and Gunther, for HPUE. Our financing strategy has three phase. The first phase that we started on back in 2015 was to shore-up liquidity. We shored-up liquidity and I think that phase whilst it's continuing it's no longer driven with the same degree of intensity as in the past because our operating performance is improving quite dramatically. We have general purpose liquidity of $9.1 billion which includes $6.1 billion of cash, the $3 billion revolver which we're currently in discussion to renew. We also have in addition $1.2 billion of vendor financing capacity.

The second phase or our financing strategy is really focused around dropping the interest expense and lowering the cost of capital. This phase will continue as we see further maturities falling due in the upcoming quarters and years. We have to continue to drop our cost of capital. And [indiscernible] (34:59) right we will be deleveraging the company and that's where we intend to get to over all, of course.

So, back on to the point of tapping the high-yield market, I would say to the extent that we can tap the high-yield market and that is the cheapest source of financing that we can get, of course we will want to consider that. But knowing that we can now issue much cheaper sources of financing, we have to be consistent with our strategy to lower cost of capital moving forward. So, for the moment, and as long as I see the high-yield markets costs being higher than what we would like, we'd probably not use the high-yield market, but I won't exclude doing so in the near future.

John, would like to talk about High Performance UE?

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

A

Sure. So, High Performance UE, Jennifer, just to recap, is the breakthrough innovation that expands our 2.5 gigahertz spectrum by up to 30% to nearly match our mid-band spectrum at 1.9 gigahertz, including indoors where the majority of our wireless traffic is generated. So, this is extremely exciting news for us. It became a standard in December 2016, I guess, a couple of weeks ago. What this means to our customers is that they will get a much better experience staying on 2.5 GHz, because that's a spectrum where we have the best performance and the highest capacity.

It also would push us to look at high-band spectrum differently in a sense that we can actually match the performance of mid-band spectrum and yet retain its high capacity capability. The ecosystem is fully behind us. As you know, the 2.5 GHz ecosystem is one of the largest LTE ecosystem globally and we expect to see phones coming out with HPUE support this year. I think Samsung has already indicated that they will be releasing phones supporting HPUE, and I think at the Mobile World Congress in Barcelona there will be more announcements about phones supporting HPUE. So, we are extremely excited. We expect to see phones this year and by 2018, we expect all of our postpaid phones with Band 41 to support HPUE.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Operator: And your next question comes from the line of Amy Yong with Macquarie. Please go ahead.

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

Q

Thank you, and good morning. Two questions. So first, Marcelo, you talked about moving into content and it seems like it's a shift in thinking. Can you just talk about your process on – your thought process behind this decision and should we expect more in the future? And secondly, can you talk about the take rates for Unlimited Freedom and at what point in time are you going actually turn away or wean off the 50% off promo? Thank you.

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

A

Thank you. So, there have been a lot of talk about content in the last couple of years in the industry. What we're trying to do with TIDAL is we have three fundamental logics behind doing the TIDAL transaction. First is associating ourselves with the owner artist TIDAL [ph] in our hope (38:23) that they're going to help us make our brand be more culturally relevant. And I think the next growth that we see is the millennials, and we see what they've done is amazing in terms of putting together a great group of artists and being able to deliver exclusive experiences, exclusive content, so that was number one.

Number two is we want to test a concept whether when you have exclusive content, in this case, music, videos, access to ticket, whether that can help us add more customers, so we use that as an acquisition machine and then, secondly, being able to provide this unique experience to our customers and let it use as a retention mechanism. And then thirdly is we think that if we put our 45 million customers and we work together and we put our assets behind, we believe that we can make TIDAL grow substantially.

So, we have those three objectives that we want to achieve. Again, it's make our brand more culture relevant, be able to acquire and retain customers by utilizing exclusive experiences, and then helping TIDAL grow. So, this is our test. We're going to push very hard for TIDAL within our customers in the next few months. And I think it's an inexpensive way to get into the exclusive content and see if it's able to drive the behavior that we think it might. So, that's our first entry into content and we're going to see where this takes us.

As it relates to Unlimited Freedom plans, they are the vast majority of what we sell today. What we see is that, in some cases, we've had weeks where over 90% of customers are coming in are signing to Unlimited Freedom, so it ranges between 75% to 90% on any given day. As it relates to eventually shutting down 50% off, our competitive rate plan, that's something that we're evaluating but what we've done is now it's only 50% their higher-end plans. So, what happens is customers come in and they look at their bill and they realize that they're way better off choosing an unlimited plan so they don't have to worry about overages or anything else.

So, obviously as we load these customers in Unlimited Freedom you're going to see an increase in the average billing per user as we're collecting more money from customers with this plan that's a little more expensive than the traditional 50% off.

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

Great. Thank you.

Operator: And your next question comes from the line of Phil Cusick with JPMorgan. Please go ahead.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Hi. Thanks, guys. Two if I can. First, Marcelo, in December, you announced the plan to create 5,000 jobs in the U.S. Can you talk about how many employees Sprint has today in total in the U.S. and how does that mix shifting over time, and do you see Sprint's head count growing from here in total? And, second, I'd like to ask about the network. You have a really impressive results from RootMetrics but other sources are not as complimentary. Can you help us understand the difference? And second, what's happening in the network densification effort where it doesn't seem like there's a lot of pick up in the progress so far, is there something in particular you're waiting for, or do you sort of – are you on purpose slowing this ramp? Thanks.

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

Great. Thank you. So, let's talk about jobs. An important area for us that's been growing is basically our digital sales or our Web sales. And what we found that there's a big component of our sales that customers start on the

Web and they eventually transition to a telesales agent in order to finalize their sale. Now, what we found is that the conversion rate for more telesales agents in the U.S. is substantially higher than telesales agents abroad.

So, the main reason for bringing those jobs or a vast majority of those jobs are going to come from us bringing jobs that were overseas today that were answering their phones that were mainly telesales and bringing them back into the U.S. So, it's a true job creation. So, we've had plans to do this for a while and, obviously, as we've seen, the conversion rate on telesales is substantially better in the U.S., this is how we plan to transition the vast majority of 5,000 jobs.

In addition, we continue to expand our distribution. We've been very public that we believe that we're under distributed, so we plan to open anywhere between 500 to 1,000 stores in the next 18 months. And if you figure that every store carries between six to ten people, you see where the job growth will come in Sprint and it's going to be mainly through distribution and bringing back agents that were sitting outside.

Today, Sprint has 30,000 people, so we believe that we're going to continuously balance as we become more effective in certain areas, we might need less employees, and whereas other areas of expansion such as retail, we plan to continue to expand. And I'm excited to bring back close to 5,000 jobs from overseas back into the U.S.

As it relates into the network status, obviously, we run our own internal test. And what you can see is that our network is performing better than ever. You can see it reflected in the lowest churn that we've had in the course of the last year. But more importantly is we like it when there's third-party firms who actually do their own research and they do their own testing and they come up with their independent study. And I think when you look at Nielsen, I think their fiscal third quarter 2016 testing basically shows that what customers care about is reliability and we're able to beat T-Mobile and we performed within 1% of Verizon and AT&T. And that's why you're going to continue to see advertising at 1% reliability within Verizon.

When you look at J.D. Power, which is one that traditionally ranks Sprint last, dead last, they did a study and they ranked – they put us second for wireless network quality in five out of six regions. We look at RootMetrics, we received 246 first-place Metro awards and more than 50% [ph] 1H 2016. (44:12) And when you look at call because people do care about making a call and the call to be perfect, this time we had more call awards than Verizon, AT&T, and T-Mobile for the first time ever.

And so, whichever way you look at our network, our network is performing way better than in the past, right? When you look at 3CA, I mean, if you have a Sprint phone, today you can clock speeds between 150 megabits per second to 200 megabits per second all across the U.S. So, I feel very good in terms of where our network is performing today. And again, like we've said, this only has been due to us basically optimizing our network and doing some basic operations for 2CA and 3CA.

Where this turned more exciting is when we densify our network and we leverage our spectrum. So we've been ramping up the pipeline of applications, and I'm really pleased with the rate of approvals that we have received so far. I think the best test to see what our network is capable of performing is what we did in New York City where we just deployed a limited amount, 200 small cells in New York City and our average download speed basically double or triple across the city all over Manhattan.

You're going to see the same when you – if you happen to go to Super Bowl where our customers are going to be where we deployed over 100 small cell in Houston. And then we have some municipalities that are understanding the concept that you need to have a dense network in order to be prepared for 5G. So, for example, I'll give you a [ph] later one (45:40) that comes to mind. I think yesterday, Cleveland basically approved every single one of the request that we had. So we have thousands of applications; we have thousands of approvals. And now we're in the process of basically putting these cells on air.

So, our network is better than ever, but what's coming is going to be a lot better as we continually densify our network. So, we're very happy where our network is and the plans that we have in order to densify our network will continue throughout this year. And you're going to see thousands of permits being approved; at the same time, thousands of new sites being put on air. That's only going to make our network even better.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Thanks, Marcelo.

Operator: And your next question comes from the line of Jonathan Chaplin with New Street. Please go ahead.

Jonathan Chaplin
Analyst, New Street Research LLP (US)

Q

Hi. Marcelo, I'm wondering if we could – so the network performance [ph] stats (46:33) that you just listed off sort of suggest steady improvement, and I'm just trying to tie that together with the increase in churn that we saw this quarter. So, you've went through the painful process of tightening credit standards, which improved the quality of the base. And we've seen this steady improvement in network quality and yet churn got worse in a quarter where it got better for AT&T and T-Mobile. It sounds like a big driver of it might have been not offering a free iPhone. Is that a decision that you made consciously and just were prepared to let subscribers go, or when you look back on the quarter now, would you have done it differently? And was that really the primary driver of churn or were there other factors that we should be looking at as well?

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

A

Great. So, first is if you adjust T-Mobile for the Walmart transactions, T-Mobile would've been flat, so I don't think everybody basically decreased. It's just the way they reported the numbers. So, we look at churn of what happened this quarter is, I think the company did a good job as it relates – it was in line with last year. I mean, last year I think was 1.53%, 1.54% versus 1.57% in what was a much more competitive quarter than a year ago.

So, three things for you to remember. One is we started growing very quickly two years ago, so this was a quarter that increased our customers rolling off commitments, I mean – or we had a lot more customers that their contracts were up for renewal. So therefore it was – we expected to have churn go up a little bit. Secondly, what we did is we chose to simplify the business and improve the economics of financing for Sprint, meaning we had a lot of customers that were in a $5 lease plan, [indiscernible] (48:22) lease plan, on a $22 lease plan, and we basically moved everybody to a $27 lease plan and therefore we knew that we're going to lose a certain amount of customers but the economic gain of collecting more from the customers that we get is significantly larger than the loss that we have by a couple of basis points of additional churn. So, we decided to make that decision and I still think it was the right decision.

And then thirdly, we decided not to participate in some of the very aggressive offers that our competitors had in national retail and we made the decision to remove subsidy from national retail and we knew that some customers who've been buying on subsidy for a very long time were not going to like transitioning to standard billing or lease. So, this was all planned and we feel that it was the right thing to do because the economic benefit is greater than the economic loss for those folks that we've lost. In addition that we're back to normal trends, we expect to return to year-over-year improvement in fiscal quarter 2016 and we expect at least a 5-basis-point sequential decline.

Jonathan Chaplin
Analyst, New Street Research LLP (US)

Q

So, Marcelo, just a follow-up, does that mean that the subs you added on those promotions that rolled off that you're willing to let go, were those NPV negative subs, or they just weren't as valuable as the ones you're adding?

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

A

You have to look at it different. I mean, you have to look at, if you're moving millions of customers basically to pay you between $5 to $10 more a month, right, you are going to lose a certain number of customers that are not willing to move to a higher $27.09 or whatever the leases we're choosing, we're charging last quarter. So, we knew we would lose a certain amount of customers but we knew that we were going to be able to collect more from the customers that it was time for them to move to a normal lease. So, when we look at all those business cases, they're all NPV positive in order for us to basically do it.

And then thirdly, we've been trying to get out of subsidy and we think it's the right thing for the business. It creates a different customer relationship when you're able to unbundle the handset and service, so the actual customer know what they're paying for and we knew that we would lose some customers in national retail when we're not offering that and Verizon was offering that. But all-in-all, I think the best way to measure is handset net adds, where that takes into consideration activations and deactivations, and I think as you saw, we've had the best net adds I think over the course of the last four years overall. We think – we're sure it was the right decision and we're going to continue to basically transition our customers in order to simplify our business to just one [ph] lease or IB (51:00) at $27.

Jonathan Chaplin
Analyst, New Street Research LLP (US)

Q

Got it. Thank you, Marcelo.

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

A

Thank you.

Operator: And your next question comes from the line of Michael Rollins with Citigroup Investment Research. Please go ahead.

Michael I. Rollins
Analyst, Citigroup Investment Research

Q

Yeah. Hi. Thanks. Good morning. I was wondering if you could talk a little bit more about the gross add picture for phones and what drove the progress in 2016 for the calendar year? And what are the actions you're taking for 2017 to further improve your productivity? Thanks.

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

A

So, I think the most – when I go back to 2016 and why we were able to have record gross adds, I think the most important part that we haven't talked a lot was of our brand, right? We continue to build our brand and value proposition on the back of our improved network. We also have a very good value proposition as customers are very pleased with our Unlimited plan and we're seeing incredibly good adoption.

In addition, I always said that one of Sprint's main handicap was the brand and the fact that our brand had suffered through Network Vision over the course of the last few years and I think when you look at – or there's an index and that index is called YouGov BrandIndex, and it's an index that we follow a lot, and that is how are customers perceiving the brand. And what we [indiscernible] (52:23) September since we launched our 1% difference, pay half as much as Verizon, utilizing the former Verizon spokesman, Paul Marcarelli, what we've seen is our brand is up 67% since September according to this Index, and if you saw the Wall Street Journal recognize our Paul campaign as the best ad in 2016.

So, when you look at that, you have a better brand, you have a better network, you have a strong value proposition, then obviously, you're going to start [ph] clocking (52:52) record gross adds. When we look at 2017 and the reason why we're not number one in net adds and we're number two is the fact that we haven't invested a lot in our distribution and you have to make choices whether you invest in the network, you invest in your distribution, you invest in your value proposition and where we're focused this year is increasing the number of stores, as we said, anywhere between 500 to 1,000 company-owned stores.

In addition, we're going to let our dealers grow because then you start getting productivity and you start putting distribution in places that matter. So, overall, you're going to see us do a lot more in distribution, our brand continues to get better, and this was the first time that we reached 20% share of gross adds in a very long time. I think it was the best in the last few years. So, when you look at all these components, we expect 2017 to continue with the same trends. We expect to add customers and we expect to have another good quarter.

Michael I. Rollins
Analyst, Citigroup Investment Research

Q

Thanks very much.

Operator: And your next question comes from the line of Matthew Niknam with Deutsche Bank. Please go ahead.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, guys. Thank you for – just two if I could, one on churn and this is alluding to a prior question. How do you go about balancing continued improvements in churn on a go-forward basis with rising retention efforts as you've got more customers rolling off promotional rate plans in the upcoming year and keep in mind again, you're sort of lapping now more and more customers coming up for grabs as your lapping the tweeter inflection growth? And then, secondly, you recently hired a new COO at a time when you've been aggressively cutting costs. Just wondering maybe, Marcelo, if you could talk about how you expect the new COO to contribute to improving efficiencies within the business. Thanks.

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

A

[indiscernible] (54:45) on churn, we are getting a lot more sophisticated and more advanced in our predictive churn modeling and we know – we have a very good idea of which customers are more prone to churn, so we're going back to those customers proactively and making sure they're upgrading. Like I said, I expect churn to be good this quarter. Actually, in a sequential decline of 5 basis points. So, I believe we have churn under control.

In addition, we're seeing great trends on churn as it relates to our iPhone Forever, which is a one-year upgrade in which customers have the ability to upgrade within one year while they still have an 18-month lease. So, this quarter in churn – this quarter increasing churn was planned, and if we would've decided not to continue with subsidy and if we would've decided to basically continue to charge people at $20 or $22 lease, our churn would've been better, the same year-over-year, but we made those decisions, like I said before, because the economic impact of those were beneficial to Sprint. So, we're running the business for profitability, not necessarily to try to beat a churn number. So I think those were the right decisions.

As it relates to [ph] exploding (56:00) promotions, and we have a lot of customers coming up from different plans, just a couple of things that I think the market didn't understand, cut your billing in half was not an [ph] exploding (56:12) promotion. Customers who were able to sign up cut your bill in half will continue to enjoy these low rates for very long time. And our 50% off does have a step up in rate, roughly after two years from activation. And our play is very simple, we want to bring customers, we want them to enjoy our network and after that, after two years, we put them back to a standard rate plan. We've done that to a few customers, and we haven't had an increasing in churn.

As it relates to new COO, I want to make sure that we're running Sprint, especially the back office, as a world-class operation. I think there's a lot of efficiencies that you can do if you're able to increase the level of care, if you're able to streamline IT in some different areas. So, for the role of COO, I've chosen Néstor. I like Néstor because I worked with Néstor in the past when Verizon had a joint venture with Tech Data, and when you look at the efficiency of Tech Data when they're able to run a business with less than 5% gross margin and operating expenses, I think, to a tune of 2%, that is very different as it relates to the cost of running a carrier.

And in having been doing this now for two years and having come from a distribution industry, I could use more executives that come with a mindset that you can do things for a lot less and be a lot more efficient, distribution, engines are incredibly efficient and I'm looking forward to having Néstor come in and bring some of his learning as it relates to running the business more efficiently. We're going to enter, I would call it a second phase of cost reduction or transformation and this one is a lot tougher and where we go next and when we update our guidance for next session and we discuss the more costs we're going to continue to take off out of the business, I felt that it was needed to bring an executive that has experience in running a business with a very low operating expense in order to complement the great team of people that we have here at Sprint.

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

Thank you, Matt.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you.

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

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

Raul Marcelo Claure

President, Chief Executive Officer & Director, Sprint Corp.

Great. I want to thank everyone for joining us today and for your continued support of Sprint. We're now heading to the final quarter of the fiscal year with a strong momentum in our turnaround as we have grew our consolidated net operating revenues year-over-year for two consecutive quarters while remaining steadfast in our cost transformation, therefore delivering over $1.6 billion of year-to-date reductions in cost of services and SG&A.

We continued to beat our two biggest competitors in postpaid phone net adds and we're postpaid net positive for the third consecutive quarter. We're confident that our densification and optimization strategy will unlock the value of our spectrum holding and we're going to continue to provide customers the best experience. I'm sure that Sprint will be best positioned of all carriers for the growing data demands of consumers in the future. We will continue to execute our transformation plan and I look forward to sharing our full-year results for 2016 and our outlook for 2017 with you next quarter. Thank you, and I hope you have a great day.

Operator: Ladies and gentlemen, thank you for your participation. This does conclude today's conference call. You may now disconnect.