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# Sprint Corp. (S)

Q1 2017 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, and thank you for standing by. Welcome to the Sprint Fiscal First Quarter 2017 Conference Call. During today's conference call, all lines 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 underway, let me remind you that our release, quarterly investor update, 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 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.

Lastly, I would like to highlight that we are no longer reporting Lifeline connections in our customer base, including our Assurance brand and Lifeline MVNOs, due to recent regulatory changes resulting in tighter restrictions on the program. The tables that accompany our results reflect the trend at comparable periods, with the removal of these Lifeline connections from our base. However, we continue to support all of our Lifeline customers.

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. I recognize that many of you are probably actively following all the press reports around potential and strategic transaction for Sprint. We have been very busy working hard to continue our momentum, while evaluating our options. We have been having many discussions, and we're very encouraged by the possibilities, but we do not have anything that we plan to announce today. I'm pleased, however, to provide you an update of the business, and our first quarter results.

It has been three years since I became CEO of Sprint and began our turnaround journey. I'm incredibly proud of everything that we have achieved in such a short period of time. There are a very few companies, if any, that have had the ability to dramatically take out costs to the tune of nearly $5 billion, while at the same time increase revenue, improve its network, and add new customers.

This momentum continued with our fiscal quarter results, which include our best financial performance in almost a decade. We reached a very important milestone by delivering net income for the first time in three years, and the highest net income in over 10 years, when excluding the impact of the Clearwire transaction in 2013. In addition, we delivered the highest quarterly adjusted EBITDA in nearly 10 years. This improving profitability was driven by growing net operating revenue year-over-year for the fourth consecutive quarter, and continue year-over-year reduction in our operating expenses.

Furthermore, we have now delivered positive adjusted free cash flow in six of the last seven quarters. We have grown our postpaid phone base for eighth consecutive quarters, and our prepaid business grew for the second consecutive quarter. At the same time, our network continues to perform at best-ever levels, and we continue to execute our densification and optimization program.

Turning to slide five. We continue to grow our retail phone connections, which generate most of the revenue and profitability for Sprint. We have built strong acquisition momentum, delivering postpaid phone gross additions that were up 4% year-over-year, and were the highest for June quarter in the last five years.

Furthermore, we improved both quantity and quality at the same time, delivering a higher prime mix of gross additions year-over-year as well. This led to postpaid phone net additions of 88,000, which marked the eighth consecutive quarter of growth. I'm encouraged by our current momentum, as we have already surpassed our phone net additions from the first quarter with over 100,000 postpaid phone net additions in just the first month of this quarter, and we're now postpaid network positive.

Our postpaid phone churn was 1.50. We also saw an increased percentage of our customers getting new devices with 6.8% of our postpaid base upgrading in the quarter, compared to 5.4% a year ago. This increase reflects a higher eligible base as well as the optionality for consumers to have access to the latest iconic devices under our iPhone Forever and Samsung Forever programs. For the full fiscal year, we expect upgrades to increase approximately 15% year-over-year.

Furthermore, we have made significant improvements in the business markets as well, with phone gross additions from business of more than 50% from a year ago. Roughly half of our enterprise gross adds were from new logos. And our enterprise churn was the lowest in over two years. Likewise, our SMB, or small and medium business group, have delivered phone net additions for four consecutive quarters.

During the last earnings call, we highlighted the return of our prepaid business to growth. We maintained that momentum in the fiscal first quarter with 35,000 net additions. Most importantly, our Boost brand, which is our primary prepaid brand with an ARPU of roughly $40 a month, delivered the highest net additions in the June quarter in the last eight years. This was partially offset by losses from our legacy Virgin offers, which we look to improve in the future with a new Virgin Inner Circle.

This result show that we have dramatically improved our brand perception and marketing effectiveness. This is further validated by the latest result from YouGov BrandIndex, which showed that Sprint is now number 11 in that awareness, and the only company in the top 20 that has increased that awareness scores this year with consumers and by significant margin.

Turning to slide six. Our network continues to improve and perform at best-ever levels. We're delivering on our goal of unlocking the value for spectrum holdings by densifying and optimizing our network to improve the customer experience.

Third-party network experts continue to recognize the improvement in Sprint's network. Independent mobile analytics firm, RootMetrics, awarded Sprint over 25% more first-place Metropolitan area RootScore Awards across all categories in the first half of 2017 compared to the year-ago testing period. In addition, RootMetrics released their national results for the first half of 2017 last week, and we're pleased to see that Sprint scores have improved in all six award categories; overall, reliability, speed, data, call and text compared to the previous report. Lastly, data from Ookla demonstrate that our network was built for unlimited data, as our average download speeds have increased 20% in the last six months.

Our densification program continues with several thousands small cells on air, as we deploy our diverse toolbox of small cell solutions, including mini macros, air poles, strand mount and Sprint Magic Boxes. We have seen great demand for innovative Magic Box with demand far outpacing supply, as we work to get into our customers. Here is an interesting fact, roughly 25% of Magic Box requests have come from non-Sprint customers who are unhappy with their in-building service from the current provider, so we see that as a tremendous opportunity for Sprint.

Masa highlighted in our last earnings call the significant performance improvement we saw in certain market areas, where we deployed our unique toolbox of solutions. Now, we're actively expanding that deployment more broadly. Sprint was the first carrier to showcase Gigabit Class LTE in the mobile network with our demonstrations in New Orleans in March. We continue to roll out these features in the network, and have recently launched our first gigabit LTE device, the Motorola Z2 Force, which we announced last week. We're also preparing our network for the growing IoT ecosystem, as we complete our deployment of our LTE Cat 1 technology across our nationwide network.

Lastly, in parallel with our 4G LTE network enhancement, we're actively preparing for 5G. We continue to partner across the global 2.5GHz or Band 41 ecosystem, including SoftBank, Qualcomm, China Mobile and others towards rolling out massive MIMO, and rapidly developing the 5G in our standards to make 2.5GHz a key band in the global 5G deployment.

Moving to slide 7. We continue to build our brand and value proposition to deliver what works for our customers. This includes simplifying our offers and the way we transact with our customers. We recently launched Sprint Flex and Sprint Deals, programs that massively simplify the wireless experience and offer customers the best way to get the latest device and the opportunity to receive annual upgrades for all the smartphones.

First, with Sprint Flex, customers can lease any phone and have the option to upgrade or purchase later. Sprint Flex allows customers to enjoy their phones, before deciding what option works best for their lifestyle, including the option to buy the phone outright at point-of-sale. With Sprint Flex, we now offer customers one primary way to get a phone, with more flexibility than ever before. Combined with their Unlimited Freedom rate plan, Sprint Flex will make it much easier for front-line employees to sell our products, but more importantly much easier for our customers to understand why Sprint is the best choice.

Second, with Spring Deals, the cost-conscious customers can have both flexibility and savings on a value menu for affordable smartphones. By grouping similarly priced devices, we have simplified the pricing for the customer to either $5 or $10 a month, with a small down payment of less than $30.

Separately, some of you have written about our recent BYOD trial offering a free year of service, and what impact this would have on the quarter. This offer represented 1% of our postpaid phone gross additions in the quarter, which was in line with our expectation, and has provided good insights into digital sales and marketing. This offer test a complete end-to-end digital acquisition model that could materially lower sales costs, if capable of scaling to a significant volume. Also, this represent a different approach with a high cost of subscriber acquisition in our industry.

All of our competitors have BYOD offers in the marketing offering cash bounty to switch. That is a big offer on cash cost of acquisition, when perhaps instead we can offer the customer a promotional period of service, for which Sprint already has the network capacity, instead of showing now so much incremental cash upfront.

Furthermore, we're optimizing and expanding our retail distribution to lower the average cost per transaction, increase our brand presence, and better serve our customers. This includes converting approximately 350 of the best performing RadioShack stores to full Sprint retail stores in just a couple of months. We're very encouraged by the early result of this 350 doors that are now delivering higher productivity per door, and we expect more total sales from the 350 converted doors than what we did with the 1,400 previously. We will continue to add more Sprint and Boost stores this year, while also obtaining existing stores to be more productive and more appealing.

Likewise, we're simultaneously ramping our digital sale capabilities and seen very good progress there as well, nearly doubling the postpaid phone gross adds in digital channel year-over-year, and nearly three times more postpaid upgrades through the digital channel compared to a year ago.

We have brought Boost back to its roots, with compelling rate plans and device offers and a brand message that appeals to the core prepaid market. While we expect Boost to continue to be a pillar for prepaid business in 2017, we're very excited about the future of our Virgin brand as well, with the recent launch of Virgin Inner Circle. This new offering combines two iconic brands, Virgin and Apple, to bring customers the only iPhone exclusive carrier with access to the global portfolio of Virgin products and services, with a great experience on the Sprint network. This also represents a new distribution model in our portfolio, as Virgin Inner Circle is only available in digital channels and in Apple retail stores.

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

## Tarek A. Robbiati

*Chief Financial Officer, Sprint Corp.*

Thank you, Marcelo. Moving to revenue on slide 8, consolidated net operating revenues of $8.2 billion for the quarter grew 2% year-over-year, and marked a fourth consecutive quarter of year-over-year growth. Meanwhile, wireless net operating revenues grew 3% year-over-year and reached five consecutive quarters of year-over-year growth, while a service revenue of over $5.7 billion remained relatively flat sequentially, and declined only 3% year-over-year when normalizing for the change in our device insurance program, which is the lowest year-over-year decline in the last 13 quarters.

Postpaid phone average billings per user was up sequentially and relatively flat year-over-year, when normalizing for the change in recognition for device insurance revenues. 85% of postpaid device activations in the quarter were financed, while 89% of postpaid phone activations were financed. The first quarter also saw an increase in the mix of postpaid device activations being leased at 55%, driven by the launch of the Samsung Galaxy S8 and the appeal of our Galaxy Forever program.

With the launch of Sprint Flex, a couple of weeks ago, to simplify our device financing through one simple option for our front-line and consumers, we expect that leasing mix for the full year in 2017 will continue to trend at a higher level year-over-year.

At the end of the quarter, 76% of our postpaid phone base was unsubsidized rate plan. This leaves only about 15% of our postpaid phone base to be transitioned to unsubsidized rate plans, assuming that penetration will level off around 90% due to business and other legacy plans. Meanwhile, our prepaid ARPU grew year-over-year to $38.24 in the fiscal first quarter.

Regarding our operating expenses on slide nine, we continue to execute on our cost transformation in the fiscal year first quarter. We realized nearly $370 million in net reductions in combined operating expenses year-over-year in the quarter, across cost of services and selling, general and administrative expenses.

Cost of services for the quarter of $1.7 billion was down 19% year-over-year, driven by lower network labor expenses, lower wireline expenses, and changes to our device insurance program, as the program revenue and cost are accounted for and reported on a net basis.

Selling, general and administrative expenses were $1.9 billion in the quarter, and were relatively flat compared to a year ago, mostly driven by higher marketing expenses, partially offset by lower customer care costs. Cost of products of $1.5 billion for the quarter increased by 9% from a year ago, mostly driven by the sale of used devices to third-parties of approximately $350 million, which had a corresponding impact to equipment revenue, and was relatively neutral to adjusted EBITDA.

We remain focused on our cost transformation, as we expect roughly $1.3 billion to $1.5 billion in net cost reductions year-over-year in fiscal year 2017, after the investment into growth platforms for the business, including retail distribution, network densification, digitalization of sales and care, and prepaid growth initiatives. Furthermore, we are already developing initiatives for additional expense reductions in 2018 and beyond to further improve margins in the future.

Now, turning to slide 10. Our adjusted EBITDA of $2.9 billion for the quarter was the highest in nearly 10 years, and improved by 16% compared to a year ago, primarily driven by the expense reductions and the growing operating revenues that I discussed. Operating income of $1.2 billion for fiscal first quarter increased by a multiple of three times, compared to the year-ago quarter, and included a net benefit of approximately $300 million from certain non-recurring items, the largest of which was the non-cash gain on spectrum swaps that we have foreshadowed last quarter.

Most importantly, on slide 11, Sprint reported net income for the first time in three years this quarter at $206 million or $0.05 per share, and improved by over $500 million compared to a net loss of $302 million or $0.08 per share in the year-ago period. Excluding the after-tax benefit of the non-recurring items I mentioned a moment ago, we delivered net income of more than $150 million or $0.04 per share.

Turning on to slide 12. Total cash expenditure were $1.6 billion in the fiscal first quarter, compared to $878 million a year ago. Excluding capitalized device leases, cash capital expenditures were $1.1 billion in the quarter, compared to $473 million in the year-ago period, with a year-over-year increase driven by the ramp-up of our densification program. Net cash provided by operating activities was $1.3 billion for the quarter, more than double compared to $542 million a year ago. Adjusted free cash flow was $239 million for the fiscal first quarter compared to $466 million last year.

As we build on the successful first quarter in fiscal year 2017, let's turn to page to our full fiscal year 2017 guidance on slide 13. We are raising the low end of our guidance, and now expect adjusted EBITDA to be $10.8 billion to $11.2 billion in fiscal year 2017, primarily driven by a continued focus on significant cost reductions. Likewise, we are also raising the low end of guidance for operating income, which is now expected to be between $2.1 billion and $2.5 billion in fiscal year 2017. This guidance include expected depreciation for leased devices of $3.5 billion to $4 billion for fiscal year 2017.

Regarding our guidance for cash capital expenditures, excluding leased devices, our guidance is unchanged as we continue to expect spending to double year-over-year to approximately $3.5 billion to $4 billion, as we ramp up our densification and utilize the expanded toolbox of cost-efficient coverage and capacity options.

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.*

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

# QUESTION AND ANSWER SECTION

**Operator**: Absolutely, sir. [Operator Instructions] Your first question comes from the line of Brett Feldman with Goldman Sachs.

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**Brett Feldman**
*Analyst, Goldman Sachs & Co.*

Q

Thanks for taking the question. One quick housekeeping one, and then a bigger picture question. On the housekeeping, you apparently adjusted your churn methodology and you broke out the impact you had on your overall postpaid churn. I'm wondering if it's the exact same impact on phone churns. That will be the first question.

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

A

Hi, Brett. Thank you. So, we did this, and I think the most important part is, this absolutely has no change or no impact on our net additions, which is the most important metric. The reason why we did that is, we wanted to have enhanced subscriber reporting, so we can better align certain early-life gross additions and the activations, and at the same time with lower gross additions and the activation by an equal amount to more effectively manage the business. So, it is – basically, this has absolutely no change whatsoever in our net additions.

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**Brett Feldman**
*Analyst, Goldman Sachs & Co.*

Q

Okay. So then, I'm going to stick with churn theme. If we look at what happened this quarter, there's actually pretty good churn results across the sector. And if we think about your positioning and your long-term growth opportunity, you sort of fundamentally set up to be a share taker. But we saw AT&T and Verizon have most of the share in the market, do a really good job retaining their customers. I'm curious on your thoughts to maybe why we've seen lower churn this quarter.

And then just, do you think there's anything you need to do just sort of shift the way you present your value proposition to the consumer in an environment where churn seems to be lower across the board?

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

A

Yeah. So, we are very confident in our ability to continue to add postpaid phone customers. However, there has been new offer from competitors. And a significant iPhone launch this year could potentially have impact churn in the coming quarters.

Every time a new carrier launches a new promotion or changes the way they do business, for example, Verizon and AT&T and T-Mobile, they all went unlimited, that automatically causes the market to shift at the beginning. And we saw that when Verizon did launch unlimited for the first time, where ports went the other way, and we had some customers went to Verizon because they wanted to basically test that.

Now, things are back to normal. I don't know – I can report to you that just this month alone, our net adds were in excess of 115,000 net adds, which is significantly more than what we did all of last quarter. So I will say that the market has gotten back to where we used to in the last couple of years. We're a lot more positive. We're taking share away pretty much from everybody, from a port perspective. So, I'd say the market is back of being normal.

When the other carriers launch unlimited, it caused a little deviation, as it usually does when somebody launches a new promotion. So we feel good in terms of our performance for this month. And we expect to have a great quarter, if things continue to be the same, which I don't expect any big changes as both Verizon and AT&T have basically gone as aggressive as I would have expected ever to have gone.

## Brett Feldman
*Analyst, Goldman Sachs & Co.*

Q

Is July usually a pretty good month? I know everyone is doing the run rate math right now.

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

A

Yeah, I'm not comparing July to other July, but I can tell you, we had a great July. And again to reiterate, our July numbers were significantly better than all of last quarter combined.

## Brett Feldman
*Analyst, Goldman Sachs & Co.*

Q

Great. Thanks for that color. I appreciate it.

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

A

Thank you.

**Operator**: Your next question comes from the line of Jonathan Chaplin with New Street.

## Jonathan Chaplin
*Analyst, New Street Research LLP (US)*

Q

Hi. Thanks for taking the question. Now that the exclusivity period with cable is done, and it doesn't seem like it's transpired into a deal. I am wondering if you can give us some context on what happened during those discussions, and where the gap was between sort of the opportunity, and where we ended up.

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

A

So, Jonathan, as you can appreciate, we don't discuss a lot of what happens as it relates to potential M&A, and we're going to leave that to final announcement that should be coming in the near future.

What I can tell you is the discussions – we're having discussions with everybody. And I think our job, when we took over Sprint three years ago, was to give Sprint – bring Sprint back to having options. And I can tell you that today, we have plenty of options, and we've had discussions with a lot of different parties. Obviously, companies that are in the same industry as we are, and companies that are not.

I was a bit surprised to see Charter's announcement in terms of that they had no interest in buying Sprint. To be clear, Sprint was never offered for Charter to buy. It was a part of the bigger play that has been reported, but I was a bit surprised to see an announcement coming like that from Charter. At this point in time, we continue discussions with different parties. And I can tell you that we are incredibly encouraged, and I think an announcement will be coming in the near future. So, we feel very good in terms of the options that we have built, and the potential transactions that we could have.

Let me dig a little more deeper and tell you that our job was to build a company that could sustain itself on a standalone basis, and we see that being good. But at the same time, the potential additional synergies that you have in doing a strategic transaction will always be significantly better than having a standalone entity. So we feel very good in terms of where we stand today.

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

Q

Thank you.

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**Operator**: Your next question comes from the line of John Hodulik with UBS.

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John C. Hodulik
*Analyst, UBS Securities LLC*

Q

Okay. Marcelo, maybe just following up on that, is it possible to talk at a high level about the value creating potential of working more closely with the cable company? I think last time we spoke, you talked a lot about or John Saw talked a lot about the strand mount and antenna, and then the work you guys you're doing with Cox. Is that – maybe talk a little bit about sort of benefits you're getting in terms of deployment of that infrastructure, and maybe the benefits of doing that more broadly. Thanks.

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

A

I mean, it's no secret that cable companies have built an amazing infrastructure that could potentially be used by any wireless operator, as 5G is all about densification of the network. And they have some great assets in terms of cable strength, and they have great assets [ph] as it relates to (26:51) potential backhaul suppliers. So as we take into consideration the potential strategic alternative that we have, we're always going to take into consideration what other assets are available in terms of potential partners.

And again, strategic transaction can mean many different things, but these are assets that are – that will be incredibly helpful to any wireless carrier as deployment of 5G becomes more and more prevalent. So that's what we see in terms of the cable companies.

And also, we've studied what has happened in Europe, and other parts of the world, where war plays have been great in terms of potentially growing the business, while at the same time reducing churn. But again, that's just one of the different strategic alternatives that we have.

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John C. Hodulik
*Analyst, UBS Securities LLC*

Q

Okay. Thanks, Marcelo.

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**Operator**: Your next question comes from the line of Philip Cusick with JPMorgan.

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Philip A. Cusick
*Analyst, JPMorgan Securities LLC*

Q

Hey, guys. Thanks. First, can you just confirm that the free for porting customers was 1% of gross adds? I think you said some maybe 3% in June. And has that run rate accelerated in July?

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

A

So, when you look at last quarter, it was 1%. And when you look at July, it's less than 1%. So the reason why we're doing this – let me take a step back, one other thing that we wanted to do is we wanted to complete a test of an end-to-end digital acquisition on a Bring Your Own Device model, on a BYOD model. And we could see, if this could materially lower shelf cost, if capable of scaling this to a significant volume. So this was a test. This continues to be a test. And this was mainly driven to Verizon customers. So that's what it was. It represented 1% of postpaid phone gross adds last quarter. And in July, I think it's even less than 1%.

Philip A. Cusick
*Analyst, JPMorgan Securities LLC*

Q

Okay.

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

A

The idea is also just to pivot away from our current acquisition model, which traditionally in this industry, have high upfront cash cost of acquisition. So, in many cases, we wanted to test a model, whether it's better to provide free service than basically giving away a free iPhone or a free Galaxy. So this is only a test, and it will continue to be a test. And if we ever decide to take this to the mass market, it will be on a later time. But at this point, it will remain just being a test, and pretty much not having a lot of materiality in terms of our financial results or subscriber results.

Philip A. Cusick
*Analyst, JPMorgan Securities LLC*

Q

Thank you. And then, second, ARPU has been slowly stabilizing. At what point can Sprint start to grow ARPU maybe? And maybe earlier than that even, can we expect sequential service revenue growth fairly soon? Thanks.

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

A

I want to let Tarek answer that.

Tarek A. Robbiati
*Chief Financial Officer, Sprint Corp.*

A

Okay. Thanks, Marcelo. Philip, good morning. So, when you look at our wireless services revenue, our wireless operating revenue were up 3% year-over-year. The wireless services revenue of $5.7 billion was relatively flat sequentially and down 3% year-over-year. It is, as you were pointing out, the lowest sequential decline in more than three years, and it's the lowest year-over-year decline in the last 13 quarters, even after normalizing for the change in the device insurance program.

The decline is mostly related to customer shifts to plan offered with device financing. This is not a new trend. And we see the postpaid phone customer base continuing to grow. You also have the dynamic that comes from the prepaid side of our business. Our prepaid services revenue was up sequentially for the first time in six quarters.

Now, the [ph] exact quarter – our shift up (30:33) to the sequential growth is somewhat dependent on the pace of shift of the remaining subsidy base to device financing plans, but right now, we are pretty comfortable with having wireless service revenue remaining stable and seeing prepaid services revenue continuing to grow.

Philip A. Cusick
*Analyst, JPMorgan Securities LLC*

Q

Okay. Thanks, Tarek.

**Operator**: Your next question comes from the line of Jennifer Fritzsche with Wells Fargo.

Jennifer M. Fritzsche
*Analyst, Wells Fargo Securities LLC*

Q

Great. Thank you for taking the question. Can you talk about how the elimination of Cut Your Bill in Half has impacted churn? I don't know if that's a question for Tarek. And then, staying on churn, how do you expect it to be impacted by upgrades going forward? Obviously, we're in front of a new iconic device launch. And so I guess the question is, does the iPhone Forever base have a different churn from the rest of the base? Thank you.

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

A

I'll take the first part, and then I'll leave the second part to Tarek. Cut Your Bill in Half was a promotion that we did that it really – there was no – the customers' bill didn't change. We basically cut their bill in half on a permanent basis. So we don't expect any different churn. As a matter of fact, churn has been very stable for those customers who've been with us now for a quite – I think we started that about two, two-and-a-half years ago. So we don't intend that to have any negative or positive adjustment toward churn.

As it relates to iconic launches, we intend to be, as usual, very aggressive. And we try to utilize this type of launches to bring more customers to Sprint. We've been able to do it in the previous years. We have a very large base of customers, who are iPhone Forever customers, which are customers that will come to get a new phone, even before their contract expires.

Now, what we found that, trend of those iPhone Forever and Samsung Forever customers is they traditionally show lower churn trends due to the fact that they are coming and getting a new device, as a device launches ahead of their contract expiration. So we'd like to call those no churn customers. So we feel confident in terms of being able to maintain the churn that we have. And we will see. Obviously, it's going to be dependent on what competitors' offers are at this time when there's new iconic devices being launched.

Tarek, go ahead.

Tarek A. Robbiati
*Chief Financial Officer, Sprint Corp.*

A

Thank you, Marcelo. Jenny, the iconic device launch is always an opportunity for us to reengage with customers. And we've launched a number of programs, iPhone Forever and so on, that allow us to continue to upgrade our base and lower our churn. So when you look at our upgrade rate for the quarter, it was 6.8% and compared to 5.4% last year and 6.1% in the prior quarter. So, sequential and year-over-year increase is mostly due to higher eligibility among those leased customers, and we look forward to iconic device launches to continue to drive higher upgrade rates amongst our customer base.

Jennifer M. Fritzsche
*Analyst, Wells Fargo Securities LLC*

Q

And, Tarek, if I may, or maybe Dr. Saw, I mean it's your expectation for this iconic device is that it would be HPUE-enabled or will we find out when the world kind of finds out?

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

A

Hey, Jennifer, John here. We do not, as a rule, make any forecast or what's in the next iconic device. So, for the Apple phone, you'll have to talk to Apple and wait for them to launch the device.

Jennifer M. Fritzsche
*Analyst, Wells Fargo Securities LLC*

Q

Got it. Thank you very much.

**Operator**: Your next question comes from the line of Simon Flannery with Morgan Stanley.

Simon Flannery
*Analyst, Morgan Stanley & Co. LLC*

Q

Great. Good morning. Thanks a lot for the question. On the churn, you've got an opportunity to close some of the gap with your peers. What do you think are the major drivers that could help improve the churn? Is it bad debt? Is it in terms of network or the customer care? What do you think the biggest buckets are there? Thank you.

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

A

It's a process, right? As you know, we continue to invest in our network to improve the user experience. We've also launched a massive simplification process. And as you can see, with the launch of Sprint Flex, now there's only one way to buy a device. It's no longer the confusion between IB, lease, subsidies, so we only have one way to buy a device. We have mainly one rate plan, which is our Unlimited Freedom plan. So it's part of having a better network on a more simplified value proposition.

Over the course of the last three years, we've tried a lot of different things, as you know, Cut Your Bill in Half and many others. And in many cases, that has caused some confusion among our customer base. So, we've gone through a massive simplification process, and that should definitely help in the end.

In addition, I'll tell you, when you have the second highest ARPU in the industry, you have to basically balance in terms of, to which customers you're able to give them similar to the promotional rate, in which you're attracting customers, and which ones you're not. And we do it different than the rest of the industry. I mean, what we try to do is basically make a business case for each specific customers, and be very selective in terms of which customers do we offer them a lower price, and which ones we're not. And in that cases, that will – in many cases, caused a little higher churn than our competitors, but the financial benefit from running the business like this [indiscernible] (36:21) business case customer by customer is a lot more rewarding than basically writing off the base like AT&T did many years back.

So we're very careful in terms of how we run our business. This turnaround, it's a big milestone to be back to profitability after – if you take out Clearwire, I think it's been – this is the highest net income that the company was able to deliver in the last 10 years. And this has been achieved by being very cautious and not taking drastic measures as it relates to your customer base, which is where most of the profit comes.

**Simon Flannery**
*Analyst, Morgan Stanley & Co. LLC*

Q

Just a quick follow-up for Tarek, if I could. the CapEx at $1.1 billion in the quarter on network, that's above your full-year run rate. Is it more front-end loaded this year? How should we think about that?

**Tarek A. Robbiati**
*Chief Financial Officer, Sprint Corp.*

A

Yeah, I mean, network CapEx was $1.1 billion in the fiscal first quarter, and it was up from $529 million from last quarter and $473 million from last year. The higher spending relates to ramping up our densification program, and there is some timing involved insofar as cash payments related to that activities are concerned. This started last quarter. This is why you have a $1.1 billion figure in the first quarter 2017.

We continue to expect fiscal 2017 network cash CapEx of $3.5 billion to $4 billion. This is a level we can support. I'm very pleased with our operating cash flow performance in excess of $1.2 billion in the quarter. And we expect future network CapEx to remain around this level for the next several quarters.

**Simon Flannery**
*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you.

**Operator**: Your next question comes from the line of Matthew Niknam with Deutsche Bank.

**Matthew Niknam**
*Analyst, Deutsche Bank Securities, Inc.*

Q

Hey, guys. Thank you for taking the questions. Just two, if I could. One on the updates in July, if you can give any color on whether that's been churn-driven or just an uptick in growth adds?

And then secondly, on handsets, you've talked about higher upgrades rates, increased velocity of devices we're seeing being traded in. Just wondering if there's an opportunity for you to more meaningfully bend the cost curve as you increasingly see these used devices and fresher devices making their way into the base. Or is there a way maybe to better monetize and profit from the sale of used devices, could have actually been just EBITDA neutral to-date? Thanks.

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

A

So, July is a combination of both. I mean, it's – I'll go back and I'll say that – and this happens to us, right, every single time we launch something new. You have the early adopters in the market, who immediately bend the curve. So I remember I'll go back in time when we launched Cut Your Bill in Half or some others, you have an initial uplift from customers coming your way.

And I think it is a same thing happened when Verizon went unlimited. The tables turned for one month or two. I mean, that's why we're only showing 88,000 net adds the last quarter, because the last – when they launched, we felt the impact. But then, those early adopters already got what they wanted, and this market has a way to adjusting and gets back to a normal. So to us, July is back to what we have forecasted going to be, it's a month of gain. And unless something changes, we expect the rest of the quarter to continue to be the same. So it's a combination of higher gross adds, it's a combination of maintaining our deacts on line to what we have forecasted.

And hopefully, we're going to be able to continue to perform the same way that we performed last year, which was a record net adds. So, hopefully, this will be a quarter that we'll continue. And if July is an indication of that, it's too early to tell, but we're very, very happy and proud of how well the team has performed in July.

As it relates to – you asked the question about used devices and others. We are the carrier who has launched leasing, and we like our leasing model. It's a model in which – it allows us to provide customers with a choice. If you study what we've done with Sprint Flex, basically it gives ability customer to come in. And a customer shouldn't be forced to make a decision whether they want an IB or whether they want a lease. We give them both options, but they can decide towards the later part of their contract which way they want to go. If they actually want to acquire their phone or they just basically want to turn in their device.

Well, we've had a lot of customers turn in their devices as they're eager to get their new iPhone or their new Galaxy. And I can tell you that pretty much we're sold out of every used devices that we received. We plan to put a lot of those into Virgin Inner Circle. We have an agreement with Apple that had been granted to us that allows us to sell used or refurbished devices under the Virgin Inner Circle. So that's where we refurbish and remanufacturing those devices that is going to be an important part of the value proposition going forward.

At the same time, we placed those devices in our main brands, on the Sprint and Boost. Boost, every single used device that we put into market is sold out. And Sprint, it has allowed us to basically put those devices into our subprime customer base and that is game changing, because it allows subprime, who traditionally doesn't have the mean to put a $200 or $300 security deposit or down payment to have excess to an iPhone device, and that has proven – or to a latest Samsung device, and that has proven to work very well.

Now, this is, obviously, in an earlier stage due to the fact that now we expect to get millions of used devices back through our iPhone Forever clients and Samsung Forever, but we feel very good that the strategy that we put forward in terms of getting back used devices and putting back into the market is going to pay out. So, we feel very confident about that strategy.

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Matthew Niknam
*Analyst, Deutsche Bank Securities, Inc.*

Q

Thank you.

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**Operator**: Your next question comes from Amir Rozwadowski with Barclays Capital.

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Amir Rozwadowski
*Analyst, Barclays Capital, Inc.*

Q

Good morning, folks, and thank you very much for taking the questions. Two, if I may. Marcelo, just wanted to follow up on prior question on subs. I believe in the past you had indicated that you expect better net adds this year versus last year. Clearly, July is already up versus the entire June quarter. Do you believe this is an achievable target to achieve this year?

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

A

Hi, Amir. We're going to tell Marcus to pronounce your last name a little better next time. Net adds, it's early, right? We just finished the first quarter, 88,000, it's okay, considering that the market was hypercompetitive. We're starting the second quarter very strong. And we hope that momentum doesn't fade.

And when I look – and we do a lot game theory, and we say, what else can our competitors – I mean, the fact that I go back and I say – the fact that Verizon and AT&T, for the last five years, having basically pushing unlimited customers out, and the fact that they have such a sudden change, and now they're all unlimited, that wasn't planned. That caught us a little by surprise, but that's all – so they basically thrown unlimited at it. And I don't see what else is coming. So assuming that nothing changes, that they don't lower the pricing [ph] on limited, (44:02) which I don't think they will, I think we're going to be in a very good place in terms of continuing gaining momentum.

T-Mobile has the same momentum. We have the same – we have a great momentum, and I see the market adjusting to what it's been in the last couple of years with – in terms of both Sprint and T-Mobile getting over 100% of the industry gain. So we'll see what happens in the next coming quarters. But we're going to work hard to make sure that we beat last year, and that's what we've been doing year-after-year and quarter-after-quarter usually.

Amir Rozwadowski
*Analyst, Barclays Capital, Inc.*
Q

That's very helpful. And then. I'd be remiss, if I didn't follow up on the discussions about potential pursuit of various strategic options. I believe that you suggested to a prior question that a pending announcement may be on the horizon. But also indicated that cable is one of many options. In the past, [ph] Samsung (44:51) had indicated that horizontal M&A with a specific player may have been a preferred option, at least a few months ago. So, really just trying to understand how to think about these comments.

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

Yeah. So, let me try to rephrase. I mean, when I tried to say make an announcement, it's we've been going at this for the last – since the spectrum auction has finished. So hopefully, this is going to come to an end in the near future, right? And let me go back and say, we are very proud that we have a company that now can sustain itself on a standalone basis. But the potential synergies and the potential value creation of some sort of horizontal or vertical integration will be significantly better than a standalone basis.

So, having said that, I think we've done the responsible thing, and that is basically talk to different players in the industry. And I think, hopefully, if we're able to come to terms, we think in the near future, we should be able to strike a deal with one of the different players. And I think now we know what are the potential opportunities are. And again, we are encouraged by what we've seen so far, and the fact that Sprint has options is where we wanted to take Sprint today.

Amir Rozwadowski
*Analyst, Barclays Capital, Inc.*
Q

Got it. So, just so we can understand, you're looking at multiple options at this point and feel like you're in a good position with those multiple options, but don't have a specific direction at which you expect to take at this point.

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

That is a great summary.

**Amir Rozwadowski**
*Analyst, Barclays Capital, Inc.*

Q

Thanks very much for the color.

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

A

Thank you.

**Operator**: Your next question comes from the line of Ric Prentiss with Raymond James.

**Ric H. Prentiss**
*Analyst, Raymond James & Associates, Inc.*

Q

Thanks. Good morning, guys. Obviously, really proud of your July results. It's quite impressive. Can you share with us maybe a little bit of the porting information? You mentioned porting mostly from everybody. Is that something you could shed a little more light on?

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

A

What we try to do is not call specifically port ratios around each of our competitors. So what we like to tell you is that, today, we are in net port positive on an aggregate basis against all of our competitors. So we don't like to specifically say which one we're more positive or if there's any that we're negative. So we like to basically tell you that overall, we're net port positive, which is definitely a very good indicator of the performance that we've had.

**Ric H. Prentiss**
*Analyst, Raymond James & Associates, Inc.*

Q

And then, obviously, the CapEx picked up. Tarek, you mentioned it looks like continue for several quarters. Can you update us a little bit just on what exactly you're buying, since it's kind of 2x where you're at? And maybe also an update on your small cell process as far as getting zoning and getting deployment of those?

**Tarek A. Robbiati**
*Chief Financial Officer, Sprint Corp.*

A

Yeah. Look, I mean, I think our CapEx spend is ramping up as a result of our densification program, but the – you get to look that dollars are going throughout improving our network. The spend goes towards small cells, but it also goes towards equipment that we've put in for other structures like towers and so on. So it's a spend that is redesigned to enhance the capabilities of our network in both in terms of capacity and coverage.

So, like I said before, $1.1 billion in the first quarter is – you have to put that in the context of the guidance that we gave $3.5 billion to $4 billion for the full year. There is also some timing impact, but this is a level of CapEx that we can sustain. Please look at our operating cash flow performance. We're very pleased that it's been a couple of quarters where we are posting in excess of $1.2 billion of operating free cash flow. We're very happy with that trend and we want to make sure that it continues to support the level of investment we need in our network.

**Ric H. Prentiss**
*Analyst, Raymond James & Associates, Inc.*

Q

And as far as zoning on small cells, has that improved? I'm just trying to get a sense of what your small cell ramps looking like?

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

A

Hey, Ric, John here.

Ric H. Prentiss
*Analyst, Raymond James & Associates, Inc.*

Q

Hi, John.

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

A

We are continuing to be pleased with the progress we are making. As you know, we have a number of new network tools for small cells, including mini macros, strand mounts, and even Magic Boxes. With regards to those small cells that require zoning and permitting, we're making good progress. We have also been working as part of the bigger industry to work with the states and local jurisdictions to make our approval more seamless. And to-date, we're just very pleased that 11 states have so far approved legislation that allows us to streamline the process as well as getting lower costs.

In terms of small cells with Magic Box, the performance continued to impress us. And as Marcelo has said, we actually don't even enough Magic Boxes to meet the surge in demand for it. So all in, Ric, we're pleased with the programs we have made, and we are starting to see the impact of the small cells on the network. As you can see from the Ookla results, our performance and speeds have been increasing.

Ric H. Prentiss
*Analyst, Raymond James & Associates, Inc.*

Q

Great. Thanks, guys.

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

A

Thanks.

**Operator**: Your next question comes from the line of Timothy Horan with Oppenheimer.

Timothy Horan
*Analyst, Oppenheimer & Co., Inc.*

Q

Thanks, guys. The churn is, obviously, also incredibly expensive. And it's one of the reasons T-Mobile's margins have improved so much. Have you guys talked at all in a while about your subscriber acquisition costs? And maybe, also on the network front, that seems to be historically the number one driver of churn, unless that's kind of changed? But when customers don't like your network or they leave because of network problems, is it because of coverage, is it because of capacity, because it seems like your speeds are really, really good at this point? And I guess, what can you do from the network perspective to really reduce churn at this point? Thanks.

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

A

So, let me try again, right? So, we're coming from behind. And like I said, this is a turnaround. And we have many different areas that we had to fix, right? The first one has been the network. And the network continues to get better. And as the network gets better, we continue to improve the network's experience. We're not only densifying our network, but we're also expanding the coverage of our networks. And unfortunately, that takes time. When it's time to got to go upgrade your network or you got to go to new towers, or you got to set up new monopoles, that takes time. And what we're doing is we're making a steady progress in terms of providing a much better experience for our customers. That's as it relates to network.

Secondly is, we're simplifying our value proposition. When you go back, at one point in time, Sprint offered over 1,700 different rate plans. Well, that makes it to be very confusing. And in Sprint, you could lease a phone, buy a phone, subsidy a phone, buy it outright, and we thought – and we saw it from – [ph] verbatim from (51:53) our customer experience that our customers were confused. So we embarked in a major signification experience, where there's only one way to buy a phone, and that's Sprint Flex, and pretty much you can only buy one rate plan, which is Unlimited.

In addition, we carry the second highest ARPU in the industry, and that's something that we want to maintain. So, therefore, the easy thing would to be basically go on and write down your base to the same acquisition price that you're bringing to your customers. And we decided we're not going to do that. We're going to do that on a transitional basis, as the financial benefit of not writing down your base to a lower price, it is significantly bigger than 10 basis points or 20 basis points of churn in terms of a positive financial impact.

So, we're running the business that way. We understand that we have a little higher churn than our competitors, in this case, T-Mobile, but we feel very comfortable running the business this way. And we're making a steady progress in terms of providing a better experience to our customers. As you've seen – I mean if you go back and you see churn, three years ago, we were the only carrier with 2-point-something in churn. And we've been getting better, on a gradually basis, and we're going to continue to get better.

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**Timothy Horan**
*Analyst, Oppenheimer & Co., Inc.*

Q

Thank you. And any color on the subscriber acquisition cost?

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

A

I mean, our subscriber acquisition cost is – we have a budget. We've been able to lower subscriber acquisition costs on an ongoing basis, and we'll continue to do it. You do that by expanding your company-owned stores, where cost of acquisition is substantially lower than third-party. Either that by digitalizing the company, where your cost of acquiring a customer in a digital basis is dramatically lower than the traditional basis.

I'm not sure if I reported or not, but our gross adds on digital channels have gone 2x, and our upgrades on digital channels are 3x. And we have very aggressive plan in terms of, especially in this iconic launches, to try to have a lot of our sales in our digital channels, where the cost of acquiring a customer is substantially lower. That is an important line that we look in our P&L, and it's something that we're monitoring on a daily basis, and we're going to continue to drive lower subscriber acquisition costs.

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**Timothy Horan**
*Analyst, Oppenheimer & Co., Inc.*

Q

Very helpful. Thank you.

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

A

Thank you.

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

Thank you. 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?

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

Thank you. So, I want to thank everyone for joining us today and for your continued support of Sprint. Our fiscal quarter results demonstrate continued progress in our five-year turnaround plan. We have improved profitability. We delivered net income for the first time in three years, and our highest adjusted EBITDA in nearly 10 years.

We again delivered positive postpaid phone net additions. Now, it's been the eighth consecutive quarter. And we're going to continue to grow our traditional prepaid business, as we've done it for two consecutive quarters. In addition, we continue to improve the network by executing our densification and optimization plan. And we look forward to continuing to deploy our unique small cell solutions across the country to make our network even better.

Again, thanks, everybody, and have a great day.

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