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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 2017 Conference Call. During today's conference call, all participants will be in a listen-only mode. Following the opening remarks, the conference will be opened for questions. I would now like to turn the call over to Mr. Jud Henry, Vice-President of Investor Relations. Please go ahead, sir.

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

Thank you, Cindy. Good morning, and welcome to Sprint's quarterly results conference call. Joining me on the call today are Sprint's CEO, Marcelo Claure; our new President and CFO, Michel Combes, and our CTO, Dr. John Saw. Before we get underway, let me remind you that our release, quarterly investor update, and presentation slides that accompany this call are all available on the Sprint Investor Relations website at www.Sprint.com/investors.

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

Raul Marcelo Claure

Chief Executive Officer & Director, Sprint Corp.

Thank you, Jud, and good morning, everyone. It's good to be here today not only to update you on another successful quarter in our turnaround journey, but also to share with you our strategy for the next phase of Sprint's turnaround. First, let me share with you our results for the quarter that reflect our continued momentum in our turnaround. I'm happy to report that we had the highest retail net additions in nearly three years. At the same time, we achieved the highest adjusted EBITDA for fiscal third quarter in 11 years and the 8th consecutive quarter of operating income. This adjusted EBITDA milestone was propelled by the transformation in our cost structure, and we have already taken out more than $1 billion of expenses this year, which marks the fourth year in a row of at least $1 billion of net reductions to cost of services and SG&A.

This improvement in profitability has helped us achieve positive adjusted free cash flow in eight of the last nine quarters. In addition, our network continue to improve as demonstrated by Ookla Speedtest data which shows Sprint's network was the most improved of any national carrier in 2017 with average download speeds up 60% year-over-year and we have now passed AT&T in average download speed during this past quarter.

Turning to slide 5. This has been another remarkable quarter as it marks the fourth consecutive quarter that we're handset net add positive in all three of our segments of consumer postpaid business and prepaid.

Our postpaid net additions were 256,000 in the third quarter, and our phone net additions of 184,000 mark the tenth consecutive quarter of growth. We estimate our share of industry postpaid phone gross add was around 20% again this quarter which continues to be nearly double our market share of 12%.

Postpaid churn was 1.71%. We recognized that our churn is higher than our peers, but let me share with you what some of the impact is by design and why we're very confident that our churn should improve in the future.

First, we can now target specific locations within our network for improvement thanks to a new tool that we have implemented called quality of experience or QOE. It is sophisticated, a statistical scoring model of each customer's network KPI based on their individual experience with us.

We find in markets in which we have deployed our tri-band LTE with three carrier aggregation have a high QOE and those customers have lower churn. In some cases, around 1%, which is very close to our competitors. This allow us to build where we can have the greatest impact on the customer experience.

This also gives us the confidence that we can deliver churn levels closer to peers with a great network, and we will share with you later on how we plan to get there.

We have also made the decision to manage the business at a higher churn rate. We're selectively managing higher ARPU subs in our base as they do not have access to our more aggressive acquisition offers and some are above our competitive rate for unlimited plans. We're comfortable using this strategy as it creates more enterprise value to have a higher churn than to write-down our base. We also see some churn pressure from leasing, but we believe that the total economics of leasing more than compensate for a higher churn level.

In addition, our business segment continues to have an amazing momentum with phone gross adds up 36% year-over-year and the lowest churn in over five years. Our small and medium business has delivered positive phone net adds for six consecutive quarters, and our enterprise group has had positive handset net adds for two consecutive quarters. This is a big achievement as this group had been losing customers for years.

Now let's discuss prepaid, where we also maintain our positive momentum in the fiscal third quarter with 63,000 net adds. This was the fourth consecutive quarter of net additions in prepaid and marks an improvement of over 500,000 year-over-year. Prepaid churn also improved year-over-year for the sixth consecutive quarter and prepaid gross adds grew year-over-year for the second consecutive quarter.

We have made tremendous improvement in the last three years as you can see reflected on slide 6. In the first phase of our transformation, we have increased our postpaid phone gross adds per year by nearly 800,000, we've gone from losing 1.3 million postpaid phone customers per year to gaining nearly 1 million last year.

We have reduced our operating expenses across cost of service and SG&A by $6 billion, and we have nearly doubled our adjusted EBITDA. In addition, we have swung from an operating loss of more than $1.5 billion to operating income of more than $2.5 billion. We have gone from burning adjusted free cash flow of more than $5 billion to generating more than $0.5 billion. As you can see, we have made tremendous improvement in the first phase of our turnaround and I could not be more excited for the next chapter of our success story based on the principles you see here on slide 7.

I am very confident in Sprint's future based on the competitive advantage that we will have with the deployment of 5G on our 2.5 GHz spectrum. We're working with Qualcomm and network and device manufacturers in order to launch the first truly mobile network in the United States by the first half of 2019. This latest development will put Sprint at the forefront of technology and innovation on par with other leading carriers around the world. This is where the power of 2.5 GHz comes to life to provide a unified 5G platform to enable innovative products and services and to partner with our sister companies under the SoftBank Group.

The Sprint is a strategic asset for SoftBank, along with leading technology companies like ARM, OneWeb, Alibaba, along with rights sharing robotic and artificial intelligence companies. Our strategy is predicated on creating an amazing customer experience, offering customers the best products and services while delivering superior financial results. First, we recognize that to be a truly a great company, we have to have a great product which for us is our network. While our network is much improved, we believe our Next-Gen Network will truly differentiate Sprint over the next couple of years due to our strong spectrum assets that enable Sprint to be the leader in the true mobile 5G.

This is the biggest network capital program in many years, and I will share more details about our network strategy in a few moments. I cannot wait to once and for all be able to sell the product that is best in the industry with competitive coverage, the fastest speed, and the highest capacity.

Second, we will continue to deliver the most compelling value proposition to our customers across all of our segments. We will continue to play from a position of strength by leveraging our spectrum holdings and continue to lead with the best unlimited offering in the market. Data usage trends are projected to grow exponentially, especially with 5G. By having the most spectrum, combined with new technology that massively increases our capacity, we're certain that we'll be best positioned for to support unlimited data in the future.

Third, we will continue to drive a smart distribution strategy with over 1,000 new stores open year-to-date across our Sprint and Boost brands and several hundred more planned throughout next year. We have designed a dynamic distribution model that allow us to continuously optimize the right balance of physical and digital distribution. The radical simplicity of our offer, OneRate plan for unlimited enable us to grow our digital transactions.

Our commercial growth strategy is fueled by continued cost transformation that is focused on maximizing operational efficiency. Our cost transformation program has led to operational improvements and we will simplify our business even further in the next phase of our turnaround. You may have seen that I have streamlined my senior leadership team in the last few months and we expect to look for ways to carry that through the rest of the organization to deliver a leaner and more agile workforce across our noncustomer facing functions. This includes reducing the total number of executives at the top and throughout the organization to get better alignment of responsibilities and better operational effectiveness.

Turning to slide 8, we will improve even more with our Next-Gen Network strategy that will deliver blazing-fast network with gigabit speeds and position Sprint to have competitive coverage and be the network leader in speed and capacity over the next couple of years.

First, we plan to increase our total number of macro sites by nearly 20% to expand our LTE footprint. And we have already issued search rings to leading tower and infrastructure companies.

Second, we're putting our spectrum resources to work as we tri-band nearly all of our existing sites with all three of our spectrum bands, 800 MHz, 1.9 GHz and 2.5 GHz, to provide great coverage and capacity across our footprint. Roughly half of our macro sites have 2.5 GHz today, and we have already started on thousands of site upgrades and expect to complete the majority of site upgrades in 2018. We have already signed agreements with two major tower companies to facilitate a swift rollout of these site upgrades.

Next, we plan to deploy more than 40,000 outdoor small cell solutions. In addition, our strategic agreements with Altice and Cox will also enable us to quickly and cost effectively deploy our various small cell solutions, including at least 15,000 strand mounted small cells and improved backhaul economics for our macro sites. We are already working to light up Long Island, and look forward to expanding the rest of Altice and Cox footprints to accelerate our network deployment.

Also, we continue deployment of Sprint Magic Boxes and plan to deploy more than one million Sprint Magic Boxes. I'm excited to say that we have already deployed more than 80,000 Sprint Magic Boxes to businesses and consumers in approximately 200 cities across the country, making this one of the largest small cell deployments in the U.S. Customers with a Magic Box are enjoying significant improvement in indoor and outdoor coverage, as well as an increasing download of speeds of more than 200%.

Furthermore, our Next-Gen Network utilizes technology such as multiple carrier aggregation, which deliver bigger pipes for faster speeds, Frame Config 2 for a greater allocation of our 2.5 GHz spectrum for downlink, and this is a TDD spectrum advantage only Sprint has for more efficient use of our spectrum capacity and beamforming for better coverage and cell edge performance.

Now let me tell you about another element of our Next-Gen Network plan that we are beyond excited about, and that is the rollout of Massive MIMO. It leverages our 2.5 GHz and creates a strategic advantage for Sprint.

Massive MIMO involves deploying a new integrated unit that will have 128 antenna elements with 64 transmitters and 64 receivers and which deliver a capacity increase of up to 10 times on LTE relative to current LTE systems, while also increasing our coverage and cell edge performance.

More importantly, because only Sprint uses TDD spectrum versus our competitors which use FDD spectrum, nearly all of our customers will be able to instantly take advantage of this significant performance enhancement on their existing devices whereas Massive MIMO on our competitors' FDD spectrum will require new devices.

Massive MIMO will also serve as Sprint's bridge to 5G, which is another strategic advantage of our 2.5 GHz spectrum as shown on slide 9. Massive MIMO radios are software upgradeable to 5G NR, allowing us to fully utilize our spectrum for both LTE and 5G simultaneously, while we enhance capacity even further with 5G and begin to support new 5G use cases.

There are a lot of claims being made about 5G by our competitors. We believe that Sprint is best positioned to be the first carrier with a nationwide mobile 5G platform.

Verizon and AT&T talk about a path to 5G, but they're relying on millimeter wave spectrum that, sure, it will give you super wide channels of capacity, but the propagation is limited to a very short distance, in most cases requiring line of sight. It is really just a hot zone and not a true mobile experience unless they spend a fortune to massively densify their network to connect the dots which will take a long time under current regulatory restrictions for permits.

Sprint is the only carrier that doesn't have to compromise what 5G can deliver because we can deliver the super-wide channels of more than 100 MHz while still delivering mid-band coverage characteristics. With more than 160 MHz of 2.5 GHz spectrum available in the top 100 U.S. markets, this gives Sprint the largest nationwide bloc of sub-6 GHz 5G spectrum available in the U.S. Sprint's priority is mobile 5G, and we expect to provide commercial services and devices by the first half of 2019.

Moving to slide 10, with this great network we're going to continue to offer the best value proposition for unlimited data in the industry. We have been the industry leader in unlimited since the beginning, and we will continue to play to our strength with more spectrum per customer of any carrier.

Sprint offers the best fully featured unlimited data plan in the industry including HD video, mobile hotspot, free data roaming in more countries than any other carrier and many other features that benefit customers, all for the best price in the industry.

To add even more value for our customers, we recently included access to Hulu in all of our unlimited plans to take mobile entertainment to a new high by combining our industry-leading unlimited service with all the hit television shows, award winning original series and popular movies Hulu has to offer.

Furthermore, on slide 11, we're optimizing and expanding our smart distribution to lower the average cost per transaction, increase our brand presence and better serve our customers. We have opened over 500 new Sprint branded stores year-to-date. In addition, we have opened over 500 new Boost stores this year as well as dramatically updating some older stores to the latest format on furnishing, which have proven to deliver greater productivity on a same-store basis.

We plan to add hundreds of more Sprint and Boost stores throughout next year, while also updating more existing stores to be more productive and appealing. And we continue to enhance our digital capabilities and I'm proud to say that My Sprint app is now rated 4.5 stars providing our customers a convenient way to check their account, upgrade their device, pay their bill, or perform many other functions instantly and easy.

Next, I'm excited to share with you some proof points that show that our strategy is working on slide 12. As I discussed a few moments ago, we're implementing our commercial strategy to deploy our Next-Gen Network, expand our retail and digital distribution and leverage target local marketing. We have accelerated this blueprint across a few markets, such as Chicago, Cincinnati and Orlando and we're seeing some very encouraging early success.

We haven't even put the full capabilities of our Next-Gen Network in place yet and our distribution is still ramping up, and yet we're already seeing improved share of postpaid gross adds in excess of 30% in this market according to estimates from KPMG and churn in the low 1% range in some of these markets. I'm optimistic that as we expand our full playbook across all the major markets, we will see further acceleration of our subscriber performance.

In a moment, I will turn the call over to Michel to take you through our financial results, but first I want to say a few things about our CFO transition. First of all, everyone at Sprint thanks Tarek for his many contributions for Sprint's turnaround success over the last couple of years. The Sprint is much stronger today thanks to Tarek, and we wish him all the best in the future. I look forward to working with Michel as we execute the next phase of our turnaround as he brings a lot of experience as a transformational specialist who believes in the importance of investing in the network and customer experience.

I'll now let Michel walk you through our financial results.

Michel Combes

President, Chief Financial Officer & Director, Sprint Corp.

Thank you, Marcelo. I am very excited to join Sprint and to be a part of this remarkable turnaround story. I am energized by the strategy that Marcelo has laid out for you, and I believe that Sprint has the best spectrum assets of any carrier I have seen in my career. I would also like to thank Tarek for his gracious support as we transitioned over the last month. Tarek has clearly helped provide Sprint with a better cost structure, a stronger balance sheet and diversified capital sources

Moving to revenue, on slide 13. Consolidated net operating revenues were $8.2 billion for the quarter. Wireless service revenue of over $5.6 billion declined 2% year-over-year when normalizing for the change in our device insurance program, which is the lowest year-over-year decline in the last 15 quarters. The sustained improvement in consumer trends has translated into better financial results as prepaid wireless service revenue grew year-over-year for the first time in nearly three years. Postpaid phone average billings per user was $68.54 were flat year-over-year on a normalized basis while postpaid average billings per account or ABPA was $170.39 for the quarter.

At the end of the quarter, 79% of our postpaid phone base was on unsubsidized rate plans. This leaves only about 10% 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 $37.46 in the fiscal third quarter.

Regarding our operating expenses on slide 14, we continued to execute on our cost transformation in the fiscal third quarter. We have realized over $1 billion in net reductions in combined operating expenses year-to-date across cost of services and SG&A expenses when you adjust for the hurricane and other nonrecurring impacts this year.

For the fiscal third quarter, our combined cost of services and SG&A improved by roughly $260 million from a year ago when excluding the hurricane and other nonrecurring items. Cost of services for the quarter of $1.7 billion was down 10% year-over-year driven by changes to our device insurance program as the program revenue and cost accounted for and reported on a net basis, as well as lower network expenses. SG&A were $2.1 billion in the quarter and were relatively flat compared to a year ago as the year-over-year increases in prepaid marketing and sales expenses were mostly offset by lower bad debt expenses.

Cost of product of $1.7 billion for the quarter decreased by 16% from a year ago, mostly driven by higher mix of postpaid activations and leasing. We remain focused on our cost transformation to deliver net cost reductions year-over-year in fiscal 2017 after investments into growth platforms for the business including retail distribution, network densification, digitalizations of sales and care and prepaid growth initiatives.

Furthermore, we are already developing initiatives for additional expense reductions in 2018 and beyond as continued cost transformation will provide the foundation to fund our growth strategy and further improve margins in the future as Marcelo outlined at the beginning of the call.

The company has taken roughly $6 billion of costs out of the business, but I will tell you that I still see more room to improve operational efficiency and extract significantly more costs out of the business by focusing on reducing complexity and improving our agility to be laser focused on our core priorities that Marcelo outlined. My goal will be to help optimize Sprint's cost structure in order to invest in our network, our value proposition and our smart distribution.

Now turning to slide 15, our adjusted EBITDA of $2.7 billion for the quarter was the highest fiscal third quarter in 11 years and improved by 11% compared to a year ago. Operating income of $727 million in fiscal third quarter, more than doubled from the year ago quarter. While this quarter included $66 million of hurricane impacts and roughly $300 million related to favorable legal settlements and other items; our operating income is up roughly $190 million year-over-year after adjusting for these special items driven by our cost transformation.

Moving to slide 16, Sprint reported net income this quarter of $7.2 billion or $1.79 per share compared to a net loss of $479 million or $0.12 per share in the year-ago period. This quarter included $7.1 billion of noncash benefit from tax reform, which is resulting from a reduction of deferred tax liabilities due to the lower corporate tax rate and an overall increase in our net deferred tax assets due to changes in the rules applicable to net operating loss carry forwards. Adjusting for these impacts of tax reform, favorable legal [ph] statements and the hurricanes (26:41), our underlying net loss has improved by roughly $300 million year-over-year driven by our cost transformation.

Turning to slide 17, total cash capital expenditures were $1.4 billion in fiscal third quarter, compared to $1.2 billion a year ago. Excluding capitalized device leases, cash capital expenditures were $696 million in the quarter, up more than 45% compared to the year-ago period with a year-over-year increase driven by the ramp-up of our network improvement initiative and our densification program.

Net cash provided by operating activities of $1.2 billion for the quarter was up nearly 80% compared to $650 million a year ago. Year-to-date, our net cash flow provided by operating activities is over $4.4 billion, which is up more than 50% year-over-year. This metric is a key focus of management as cash is king and it is the optimum source of funding for our growth initiatives and network investments.

Adjusted free cash flow was $397 million of fiscal third quarter and $1.1 billion on a year-to-date basis. We have now reported positive adjusted free cash flow in eight of the last nine quarters. While we do expect adjusted free cash flow to be negative in fiscal fourth quarter due to increased network CapEx, we are clearly making strong progress in consistent adjusted free cash flow generation.

We also continue to strengthen our balance sheet as we retired $2 billion of debt during the quarter. This included the final payments on the second tranche of MLS, $1.3 billion payments under our Network LeaseCo facility, and the early retirement of the Clearwire exchangeable notes that were callable on December 1.

Subsequent to the end of the quarter, we made the final payment under our Network LeaseCo facility in January and have now terminated that facility. These facilities or notes all add interest rates in the mid- to high-single digits, so these payments allow us to further reduce our future interest expenses.

Moving forward, we would expect to raise additional capital in the coming months to prefund our capital deployment plans. This activity would include issuing the second tranche of spectrum-backed notes under the existing $7 billion program. However, given the strength of global capital markets, we may look at other markets opportunistically as well.

As we move into the last quarter of fiscal 2017, let's turn the page to our full fiscal year 2017 guidance on slide 18. We expect to be near the midpoint of our adjusted EBITDA guidance of $10.8 billion to $11.2 billion in fiscal 2017. We are raising our operating income guidance from $2.1 billion to $2.5 billion, and now expect $2.5 billion to $2.7 billion in fiscal year 2017 to reflect the favorable legal settlements this past quarter. This guidance includes expected depreciation for lease device of $3.6 billion to $3.8 billion for fiscal 2017.

Regarding our guidance for cash capital expenditures, excluding lease devices, we continue to expect spending to increase significantly year-over-year but now expect CapEx to be near the low end of our guidance of $3.5 billion to $4 billion. We continue to expect CapEx to increase to $5 billion to $6 billion in fiscal 2018.

Lastly, we are raising our guidance for adjusted free cash flow to $500 million to $700 million versus our previous expectations to be around breakeven, reflecting our strong performance year-to-date.

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

Jud Henry

Vice President & Head of Investor Relations, Sprint Corp.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Philip Cusick from JPMorgan Securities.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Thanks, guys. Two, if I can. First, Marcelo can you talk about Sprint's role in the SoftBank ecosystem? What synergies do you see with the ARM, OneWeb, Brightstar, Uber and others? And is there anything that's lost in having a public Sprint stub? And then one for Michel, welcome aboard, you pointed out that prepaid revenue is growing now, can you give us an update on how you see total service revenue trending? Can this stabilize in the next few quarters? Thanks.

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

A

Thanks for your question. So when we sit down and we start finding areas that make Sprint different than the rest – or big differentiators, we point out to two, right? One is our sub-6 GHz spectrum that we spoke in the call, and the ability for us to be the only company that can deploy a mobile 5G in early 2019.

And that is quite important because once you have this advanced 5G ecosystem, then you start thinking differently on how do you fit within the SoftBank ecosystem. As you know, SoftBank is the largest shareholder in many right-sharing companies and the future of right-sharing obviously is linked to connected cars, autonomous cars which require 5G type of networks. When you look at the future of IoT, ARM plays a key role in terms of defining the future of what is IoT going to be like, and it's definitely very helpful for Sprint to have a close relationship as they're both majority owned or in the case of ARM, completely owned. When you look at our longer-term project such as OneWeb and the potential launch in excess of 900 satellites in the low orbit satellite in the next couple of years; that could be an amazing supplement to a rural strategy that we have.

So when you look at ARM, OneWeb and other right-sharing companies, we're now starting to work all together to figure out how we can leverage each other's position for strength. But I will say more importantly is for Sprint to build a network that is going to satisfy their needs. The same applies to other robotic companies that SoftBank has acquired, and if you look at all those companies, all of them need the type of connectivity that we plan to bring, which is blazing gigabit speeds with most importantly low latency which is basically the future of 5G and the future of connecting the Internet of Things.

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

A

On the second question. First, thanks, Phil. As I pointed out, wireless services revenue of $5.6 billion was down less than 1% sequentially and down 2% year-over-year, which shows that we have had our lowest year-over-year decline in the last 15 quarters when normalizing for the change in devices insurance program. So I guess that it's fair to expect that we should reach growth in service revenue by the end of fiscal year 2018. It's always a little bit difficult to predict quarter-on-quarter, but what we have seen during this quarter, the sequential decline of only $30 million, the fact that we have reignited growth in prepay, I guess that we have the report to come to this outcome by the end of 2018.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Thanks, Michel. Marcelo if I can follow up, do you see anything lost in having a public stub at Sprint? As you said, SoftBank is an investor in a lot of companies where it's not a full owner. Is there any difference with Sprint?

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

So the going-private question is one that we get asked a lot of times, and I'll refer you that the ultimate question that is for SoftBank. [ph] First (35:30) SoftBank had been buying shares in the open market as a result of their strong belief in the Sprint future value, and becoming a wholly-owned subsidiary of SoftBank could be a possibility, but that obviously would depend 100% on Masa and I will let Masa answer that question. I guess he has an earnings call very soon.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Thanks very much.

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

Amir Rozwadowski
Analyst, Barclays Capital, Inc.
Q

Thank you very much, and good morning, folks. Thanks for taking the questions. Marcelo, maybe the first in terms of your commentary around how you approach churn going forward, you mentioned that you're happy to run it a higher level, but do you believe that given some of the initiatives that you have in place as you mentioned that you should see churn reduce on a year-over-year basis going forward?

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

So let's talk about churn, and that's always a hot topic of our calls. First let me – let's admit that there are further improvements to our network that needs to be made and those are going to reduce our churn. And let me walk you through something that we call QOE or quality of experience. What we have done is we've put close to 45 million retail customers, we have [ph] assigned an score (36:56), and that's based on the network experience that they're getting, based on the applications that they're using. And it took us a long time to basically – and this is a statistical dynamic model.

But what that allows us to do is in places where we're offering the quality of experience greater than three or four, this is one to five score, basically our churn falls in the range of 1% to 1.3%, which is exactly where we want to run our business. So what we need to do is we basically have to build – continue to build our network. But it's – we've done enough studies that basically show, if we provide the right quality of experience, a Sprint customer will stay with us and in many cases the churn is the same as our competitors. So that's one.

Now, there's also certain things that we do to have a higher churn, and we run the business from a value creation model. For example, when you're running a business model that allows customers to be out of a contract after 18 months because you're running an 18-month lease, that you have more customers out of contract meaning you're going to have a higher churn. However, the positive value of leasing is significantly higher than the cost of – than based on the churn – than the cost that you're creating by having a higher churn.

The same applies with certain customers who we don't voluntarily reach out to them, that they're on higher priced plans. If they proactively come to us, we will take them to a lower plan, but we're not proactively telling customers that they're at a higher rate plan. Those customers are at a higher churn but the additional revenue that would generate from those customers is significantly higher than the cost of churn. Now, as we predict churn, as we look at our churn models, obviously we're going to look at churn coming down in the next few years as we do our investment in our network and as we roll out our 5G network. So we know exactly what churn is going to be. We can predict it and we feel that next year churn will be better than this year's churn.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

That's very helpful. And then a follow up in terms of your network strategy. You folks are targeting 5G network based on 2.5 GHz in the first half of 2019. How do we think about sort of the approach to the rollout here? I mean, are you seeing standard base equipment in terms of timing? And then, obviously, you've made a number of announcements with cable providers to get you the necessary densification and backhaul infrastructure that you need. Just trying to assess do you believe that you have the pieces in place at this juncture to really push forward with that first half 2019 target?

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

A

Yes. So obviously our priority is to launch mobile 5G, a true nationwide mobile 5G network in 2019. So in order for that to happen, we basically have to have agreements with three different type of vendors. The first one is with our network vendors and through the strategy that we have of deploying Massive MIMO first and then converting that to 5G and Dr. Saw can speak a little more to that. That had been confirmed.

The second one was basically speaking to Qualcomm and whether they're able to build a chipset that will allow the different phone manufacturers to be ready on time, and we have come to an agreement with Qualcomm that they are going to be able to release this towards the later end of 2018, the new chipset, so this is going to be positive for us.

And we have had a conversation with a manufacturer, a leading Korean manufacturer to basically have devices ready by the first half of 2019. So we have the three parts that we need in order to make a commitment to launch by first half of 2019, and this is very different than the networks that our competitors are announcing, due to the fact that this is going to be in our 2.5 GHz band in which we have over 100 megahertz of capacity to dedicate to 5G. There are very few companies in the world that are going to be able to launch a mobile 5G network. Most of them are going to be doing small millimeter wave launches, which is going to be very different.

So we are more excited than ever in terms of putting Sprint back at the forefront of technology by having what I believe will be the first mobile – the first mobile 5G network.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thank you very much for the incremental color.

Operator: Your next question is from Jennifer Fritzsche from Wells Fargo.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Thank you. Two, if I may. Can you talk a little bit about the insurance program? I believe you said in the write-up that half of the decline in wireless service revenue is due to this, although I know this could be accretive to EBITDA. When will this abate a little bit or will that go until we see the point of growth at the end of this year? And then a second maybe for Michel. When should we expect the next iteration of Spectrum LeaseCo? I guess the question would be do you expect any hurdles or restrictive covenants? And you mentioned other markets. Should we assume other financing to be in the high yield market? Thank you.

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

A

Hi Jen, this is Marcelo. Could you repeat your first question for me?

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Sure. On the insurance program, I believe that accounted for half the decline in wireless service revenue. Should that abate soon, that insurance impact?

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

A

I think we're getting close to a year of actually having rolled out the new Asurion programs, so I think going forward, if the calculations year-over-year should be – you shouldn't take into – it shouldn't take into consideration the changes on insurance.

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

A

Yeah, Jennifer. This is Jud. That program went into effect on January 1, so this fiscal third quarter was the last quarter we will see a material impact there and you should have a pretty clean view as we go into our fourth fiscal quarter here.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you. And if I could on the Spectrum LeaseCo and high yield.

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

A

Yes. So I guess that, in terms of funding our business, our strategy, as you know, is to diversify our sources of funding in order to allow our cost of capital and spectrum interest expenses. So as I have alluded to, the intent is obviously to go for the second tranche of our spectrum financing in the next coming weeks. So that's something that we contemplate and that we intend to do. And what I have just mentioned is that as the market is quite good, we might also contemplate to tap other compartments of the financial market to [ph] tread higher yields (43:51).

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you very much.

Operator: Your next question comes from Brett Feldman from Goldman Sachs.

Brett Feldman
Analyst, Goldman Sachs & Co. LLC

Q

Thanks for the question. If we can talk about your cable partnerships a little bit. Obviously, the relationships you've created with Altice and Cox are going to give you access to dense broadband infrastructure, particularly fiber infrastructure, in the markets where those companies operate, but that's still a subset of the country. So I was hoping you could maybe expand upon how you're going to ensure that Sprint has access to the fiber that you need to densify the sites for a mobile 5G network and I'm particularly interested in whether you think there is opportunity to work with the other major cable companies. Thanks.

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

A

Okay. So let's recap the two partnerships that we have. The first one is with Altice, and Altice is a combination of an MVNO partnership combined with them giving us access to their cable infrastructure. We are, I think, the first proof point is going to be on Long Island, as we're massively densifying Long Island utilizing our technology and utilizing their infrastructure.

Secondly, as part of the legal settlement with Cox, we have come to a similar agreement. It is not an MVNO agreement. It is basically – it gives us access at highly preferred rates to their infrastructure and it allows us to have a second proof point. We've always been very bold that we believe in fixed wireless convergence in the future and this is just another proof point that we want to make sure that we can prove to ourselves and prove to the market that a combination of our wireless spectrum combined with cable infrastructure is a winning combination in the U.S. like it's a winning combination in the rest of the world.

As it relates to how we plan to build our network in the future and whether we see other potential partnerships with cable companies, I think that's wide open and I think they have – I believe that they have expressed the same – the same potential partnerships for the future. But I think what we want to do this time is we want to prove the model. We want to prove that you can build an incredibly dense network by leveraging each other's assets. And we're doing that in two maybe smaller markets that could potentially serve as a proof point for any future potential partnership with cable company.

Brett Feldman
Analyst, Goldman Sachs & Co. LLC

Q

Thanks for that color. And just as a quick follow up. When you think broadly about the fiber options available to you, how do you feel about other third-party options and is there a component of that $5 billion to $6 billion that you're targeting for next fiscal year that actually involves fiber densification?

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

A

Brad, John Saw here. The answer is yes. We are working aggressively with a lot of other fiber providers, companies like Zayo where we are bringing a lot of dark fiber to our sites. And this is especially important now as we roll out more and more sites requiring Massive MIMO to support 5G as well, that we do this even more aggressively. So a chunk of our CapEx spend is actually upgrading our backhaul networks using dark fiber, getting better lit fiber pricing [indiscernible] (47:01) gigabit per second, as well as continuing to use microwave backhaul where it makes sense.

Brett Feldman
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks for the color.

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

A

Yeah.

Operator: Your next question comes from John Hodulik from UBS Securities.

John C. Hodulik
Analyst, UBS Securities LLC

Q

Great. Thanks. Two, if I may. Maybe first for Michel. You talked about some potential new areas for cost savings. Sprint has wireless margins now of about 35%. I realize you're sort of looking at it with a new set of eyes here, but do you see, given your experience, that there's some potential for meaningful margin accretion from here? Even with the new costs that should come on with the network build-out? And then maybe for Marcelo, maybe just some general comments on what you're seeing in terms of the competitive environment. In past quarters you've talked about the ability or the need to raise prices. Is that still where Sprint is? And if you could talk about that as it relates to ongoing ARPU trends of the company, that'd be great.

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

A

Thanks, John. So on your first question, I guess first is, we should recognize that great work has been done up to now as we are on track to deliver the fourth year in a row of at least $1 billion of net reductions to our cost of services and SG&A. So which is quite a significant achievement. We are currently working with the team on new initiatives for 2018 and the years beyond in order to let's say continue to decrease our cost structure in the next coming years. I am very confident that there are lots of areas where we can still dig in while let's say of course preserving our investments in the three priorities which have been outlined by Marcelo.

So from my experience in other places, I see a lot of, let's say, potential there. And I will provide more specifics on next quarter call in conjunction with our annual guidance. You can expect that that there is still room of maneuver to decrease and to invest in the future of our business.

John C. Hodulik
Analyst, UBS Securities LLC

Q

Great.

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

A

So as it relates to the competitiveness in the market, it is competitive. Everybody has moved to buy one phone, get one free, and throw in a lot more into their unlimited. We feel we're in a very good position. If you look at our gross adds growth, year-over-year has been – we've been having it now four years, in which we continue to grow our gross adds pretty much on the last three years. So we have absolutely no problem in getting our share of the market when you look at our share of gross adds, close to the 20% range. And anytime you have a 20% share of gross adds with a market share of 12%, that is absolutely good.

What I can tell you is as a company, we could not be more excited that 5G is coming, right, and we see 5G as a very important milestone in the history of Sprint because we have the spectrum to basically lead on 5G and lead in a different way.

So we look at from other carriers, it is going to be very difficult for competitors to increase the price of unlimited, but we're going to have a lot of room to increase our price of unlimited to get to similar prices as Verizon and AT&T in the future. And you get that by having an amazing network. And you get that by being the first one to launch 5G. So we're looking at 5G as an amazing opportunity for the company not only to again to lead from a value proposition, lead with a great product, but potentially be able to charge for the blazing fast speeds.

Also something that allows you to do that is when you look at 5G, you have a significant reduction on your cost per gig, and that is also another – that's also another advantage that will allow us to potentially get in the place where we'd like to be, and that is be able to charge for our services while at the same time be able to reduce cost or having the lowest cost per bit.

As we relate from now till the time we launch our 5G network, which we're looking at a year, we have already increased our price. We used to be basically the first two lines for $90, now the second two lines are for $100 and then we're going to continue to look at the market and be able to see if there's extra room in order for us to be able to capture that share of gross adds that we feel comfortable plus minus 20%, while at the same time being able to charge the most amount that we can for our services.

John C. Hodulik
Analyst, UBS Securities LLC

Q

Got you. Thanks, guys.

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

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

A

Mike, you there? All right. Cindy, let's go to the next question.

Operator: Your next question comes from Matthew Niknam from Deutsche Bank.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Hey guys. Thank you for taking the question. Just one on leasing and then just one housekeeping item. On leasing, I think Marcelo you referred to it as a driver of some of the pressure this quarter on churn. In the past, I think you've actually referred to it as a churn killer about a year or a year-and-a-half ago when it was first introduced. So can you maybe talk to what's changed there? And then secondly, on CapEx, if you could just shed more light on what's driving some of the lower CapEx expectation this year, and then whether this is more of a deferral into fiscal 2018? Thanks.

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

A

Yes, our leasing program is working. It's actually working great, and it's giving us the profitability that we had expected when you have – when you're the only carrier with a leasing program. A couple of things that are important for us as it relates to leasing.

Before, we used to have a 24-month lease. We've moved to an 18-month lease with the ability of customers to upgrade after one year with an iPhone Forever or a Galaxy Forever. So in that case, you are going to have a little more churn because you have a larger amount of customers off contract, and this basically hasn't changed in our industry. Once a customer [ph] hit (53:42), they're off contract, they basically shop around, and in many cases, they will decide to go somewhere else if the offer is better.

Now, the customers that are within our – the customers that are upgrading within our 12-month program, we're seeing incredible low churn rates, and our goal is going to be over the course of the next few years to perfect the model where a customer is upgrading prior to their 18-month when their contract expires. So obviously there's different ways to get ahold of our customers. Leasing is new, but those customers absolutely, I mean, they are – they have a great churn profile.

Where things – where churn gets a little higher, it's basically when the customer is out of the contract after 18 months, and we're working on moving the least amount of customers there. So as I said before, we're very happy with leasing. The profit that we get from leasing, it's positive. The ability to pick up millions of used iPhones or used Galaxys and be able to remanufacture them and put them into our both our prepaid and postpaid businesses and be able to either subsidize less or use less cash in bringing those phones and bringing those customers is positive. So we've got to let the cycle of leasing basically to continue.

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

A

On network CapEx, so as I have mentioned, we have $200 million year-over-year increase, so – which has been driven by the ramp-up of our network improvement initiatives and densification program. We will see an acceleration in next quarter. While it says in the guidance that I gave you implies a minimum of $1 billion spent in fiscal Q4 2017, and we should see an acceleration in 2018. This is driven by the fact that we're moving to more expensive upgrades, new sites built which are, let's say, are going to kick in, and a Massive MIMO, which will also start to roll out in the next coming quarters.

So that's what will pave the way for the next iteration of our CapEx spend in the next coming quarters, and that's why we are comfortable with the indications that I gave you for next year.

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

A

Let me give you a follow-up answer as it relates to leasing churn build-out and all those. So we're going through a cycle right now where we have the highest amount – where we've had over the last quarters the highest amount of customers off a contract, and that has created a higher churn than what we had before.

At the same time, as our competitors have launched unlimited, we are going to invest a lot of money into our network to basically deploy our 5G network. So when we look at our churn curve over the course of the next few years, what we've seen is this has been a year with a higher churn than last year. We expect this to peak in fiscal 2018, and then after that, basically for our churn to come down to similar levels that we've had in the past.

So we have very aggressive churn reductions over the course of the next few years. And I'll tell you, what I've learned and what has been an eye opening for us and hope would have realized it before, is the ability of launching our quality of experience and be able to pretty much forecast that Sprint has the ability to get down to churn levels that are similar to our competitors once we're offering a great quality of experience. So we're going to work hard in terms of lowering churn over the course of the next few quarters and years.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Marcelo, if I could just follow up, I just want to clarify. So you're saying that for the fiscal 2018, churn will peak before trending lower in fiscal 2019?

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

A

That is correct.

Matthew Niknam
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

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

All right. Cindy, that's all the time we have for questions today, but before we close, I'd like to turn the call 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
Chief Executive Officer & Director, Sprint Corp.

Great. I want to thank everyone for joining us today and for your support of Sprint. Our fiscal third quarter results demonstrate continued progress in our five-year turnaround plan. We have improved profitability, delivering our highest fiscal third quarter adjusted EBITDA in 11 years, our eighth consecutive quarter of operating income, and positive adjusted free cash flow in eight of the last nine quarters. We delivered positive postpaid phone net additions for the tenth consecutive quarter and continue to grow our prepaid business for the fourth consecutive quarter.

I cannot emphasize enough how excited I am about the future of Sprint as we deploy our Next-Gen Network, we expand our physical distribution, and enhance our value proposition and continue to transform our cost structure. I'm excited for Sprint to take the leadership position as the first nationwide mobile 5G network and devices in the U.S. I look forward to sharing more info of our transformation success on our future calls. Thanks everybody for joining us today, and have a great day.

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