03-May-2017

Sprint Corp. (S)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

I would now like to turn the conference over to Mr. Jud Henry, Vice President of Investor Relations. Please go ahead, Sir.

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

Good morning, and welcome to Sprint's Quarterly Results Conference call. Joining me on the call today are Sprint's President and CEO, Marcelo Claure; our CFO, Tarek Robbiati; and our Chairman, Masayoshi Son. 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 may involve 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 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, all references to customers or connections in our remarks represent results or expectations for the Sprint platform unless otherwise indicated.

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

Raul Marcelo Claure

President, Chief Executive Officer & Director, Sprint Corp.

Thank you, Jud, and good morning everyone. I could not be more proud of Sprint's fiscal 2016 results and what our team has accomplished to-date at the halfway point of our five-year turnaround plan.

As I have said before, there's no better indicator of a successful turnaround than when a company returns to top-line growth. That is exactly what we did in fiscal 2016 growing net operating revenue year-over-year for the first time in three years as we ended the year with three consecutive quarters of year-over-year growth.

Our discipline to transform our business and the underlying cost structure delivers a $2.1 billion reduction in cost of services and SG&A in fiscal 2016 and an impressive $3.5 billion in the last two years. This ability to grow revenue while cutting cost at the same time is a testament to the improved operational efficiency and momentum that deliver the highest adjusted EBITDA in nine years, the highest operating income in 10 years, and we deliver positive adjusted free cash flow. We more than double our postpaid phone net additions year-over-year in fiscal 2016, and the prepaid business returned to growth as we exited fiscal 2016 with more exciting things to come in fiscal 2017.

In addition, as you all know, Sprint's network has been widely acclaimed as being the most improved network over the past year, further validating that network quality is not solely dependent on how much money you spend, but rather how effectively you utilize the assets that you have despite what our competitors want you to believe. And as you will hear from Masa, our Chairman, shortly, we have a diverse toolbox of innovative and capital-efficient solutions that will enable us to reach our goal of having the best network in the near future.

In particular, I'm very excited to share with you an amazing innovation called the Sprint Magic Box. Magic Box is the low-cost, self-configuring LTE small cell that is being used to dramatically improve the user experience particularly in their indoor coverage and is up and running in 15 minutes.

We successfully balanced achieving our highest financial milestones in many years while significantly beating our two biggest competitors in the most important postpaid phone net additions as we added 1 million more than Verizon this year and 2 million more than AT&T. These results illustrate that Sprint has good operating momentum as we enter a highly-anticipated period of many strategic opportunities. We have generated significant shareholder value over the first half of our turnaround and that gives us the confidence and the patience to evaluate any potential strategic opportunities, believing that at the end of the day we have a strong standalone case.

Turning to slide 5, our customer growth continue in fiscal 2016 with 1.9 million total net additions for the year. Our postpaid phone net additions of 930,000 were the highest in four years and more than doubled year-over-year. Even more impressive is the swing of 2.5 million in just two years, from a loss of 1.5 million postpaid phones in 2014 to almost adding 1 million in 2016. Our postpaid phone gross additions were also the highest in four years and up 10% year-over-year. We deliver our lowest ever postpaid phone churn in fiscal 2016 at 1.48% with churn in the fourth quarter being relatively flat year-over-year.

Despite our competitors following us into unlimited data plans this quarter, we delivered 42,000 postpaid phone net additions in the fourth quarter, extending our streak to 10 consecutive quarters of year-over-year improvement. Furthermore, we were the only carrier to grow postpaid phone gross adds year-over-year in the fourth quarter while growing our share of industry gross adds by over 250 basis points year-over-year.

In addition, we have now surpassed Verizon for five consecutive quarters in postpaid phone net additions as we deliver 300,000 more than Verizon this quarter. And we have also surpassed AT&T for the tenth consecutive quarter by adding more than 400,000 in this quarter.

In our last earnings call we said that we're putting more attention on our prepaid business. Well, our prepaid business returned to growth exiting fiscal 2016 with positive net addition of 180,000 in the fourth quarter. Most importantly, our main brand, Boost, which is our primary prepaid brand with an ARPU of roughly $40 a month, deliver even greater net additions in the fourth quarter. Our next step will be a relaunch of the Virgin brand with a unique and disruptive offer in conjunction with Apple. Lastly, our wholesale and affiliate business continues to grow with net addition of 2.1 million this year.

Moving to slide 6, we continue to build our brand and value proposition on the back of our improved network. We have played to our strength by going all-in on Unlimited Freedom as our sole offer for postpaid, giving customers value and simplicity with a simple and straightforward plan coupled with Sprint's reliable network. With the capacity and reliability of our LTE Plus network and the most spectrum per retail customer of any carrier, we are able to dramatically simplify our rate plans and give customer the peace of mind to not think about their data plans anymore.

Likewise, we have brought back Boost's strength with compelling rate plans and device offers with a brand message that appeals to the core prepaid market. We expect Boost to continue to be a pillar of our prepaid business in 2017 as we have exciting plans for other prepaid brands this year as well. We're also providing our customers with the best service when they leave the United States by offering free data service to more destinations than any other carrier in the U.S, 165 countries. Customers shouldn't have to set-up or trade-off when roaming overseas. Neither AT&T nor Verizon offer a free data option abroad and T-Mobile doesn't currently offer 4G speeds outside of Canada and Mexico. Sprint has more low-cost coverage than all three competitors and Sprint customers don't have to make any more trade-offs.

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 several hundreds of the best-performing RadioShack stores to full Sprint retail stores over the next few months, which we expect to deliver more total productivity than we experienced from the 1,300 RadioShack stores under the store-within-a-store model that was discontinued at the end of this fiscal year. We will continue to add more Sprint and Boost stores this year while also updating existing stores to be more productive and be more appealing.

This has been an amazing year as we have demonstrated that having an award-winning network is not tied to how many billions of dollars you spend. Our LTE Plus network continues to improve and perform at best-ever levels and we're delivering on our goal of unlocking the value of our large spectrum holding by densifying and optimizing our network to provide customers with the best experience.

When we ask consumers what is the most important aspect of the wireless experience, they respond that network reliability and consistently high voice quality have the greatest impact on their daily lives and that's where Sprint's network continues to deliver.

Drive tests from Nielsen show that Sprint's network reliability has continued to be best in class and within less than 1% of AT&T and Verizon. In addition, independent mobile analytics firm RootMetrics awarded Sprint over

30% more first-place metropolitan area RootScore Awards in the 76 markets measured so far in the first half of 2017 compared to the year-ago testing period.

Speaking of the customer experience, you may have seen in the media that J.D. Power, the leader in independent industry benchmark studies, now ranks Sprint second out of all national carriers for wireless network quality, ahead of AT&T and T-Mobile in all geographic regions of the U.S. in its latest wireless network quality performance study. This is very compelling because it is based on actual customers' feedback, based on their experience with our vastly improved network.

Our densification program continues to build momentum as we now have thousands of permits in hand and we're ramping up construction in many markets.

In addition, as you're well aware, Sprint has already deployed three-channel carrier aggregation in over 100 markets. The best part of our carrier aggregation deployment is how seamless it is thanks to the fact that we utilize radios and antennas capable of multiple carriers when we originally deploy our 2.5 GHz, and as a result, generally, we do not need to go back to the tower each time that we light up another 20 MHz channel offer through those pipes.

This increased depth of 2.5 GHz has allowed us to shift the majority of our LTE traffic onto the superhighway, which also provides a halo benefit to the customer experience by relieving capacity on the 801.9 LTE layer.

Furthermore, Sprint was the first carrier to demonstrate gigabit-plus LTE in a public venue with a demonstration in Eurolink in March.

Now, I'll like to turn the call over to my chairman, Masa, to share with you how Sprint expects to make our network even greater in the future.

Masayoshi Son

Chairman, Sprint Corp.

Hey. Thank you, Marcelo. This is Masa. Marcelo is my boss. I have to report to Marcelo how I run the network operation, so I'm happy to tell you about the great progress we've made.

So look at page 8, many people still may have the Sprint network is not as good as anybody else. Many people think that we are number four. The reality is a little different. We are number two in voice performance nationwide. We used to be number four, but now we jumped up and became number two nationwide.

But also on the left-hand side of this page you see, most metro, we actually became number one in voice award. This is the progress we've made, not just voice but we are going to be number one or number two also on the data with LTE performance.

So page 9 says that why we are going to be number one or number two in most markets in data also is because we have spectrum; we have innovation. These are the two reasons why we are going to make great progress.

Page 10 as you can see, we have such a huge asset of 2.5 GHz spectrum, with High Power UE. So we expect going forward with our deployment of the new network, almost 90% of the total traffic capacity goes go through our 2.5 GHz and with our High Power UE, we are becoming good enough as much as the 1.9 GHz coverage. And 800 MHz will cover all the spillover of the coverage. That's where we have the strength, in 2.5 GHz.

So running High Power UE, page 11 says, used to be 2.5 GHz does not cover long enough distance, big enough penetration inside the building but by increasing the power in the handset unit with the new standard we create, agreed this year by all the major key players of the handsets, key players of the components, we have established a new standard and that is the High Power UE. With this new standard in technology, our 2.5 gig now goes inside the building and the giga distance coverage as good as the mid-band. That's the great improvement of our capability.

So we've got spectrum and new standard; now we have on top of that a new innovation of the tools. So page 12, five major new tools that we have invented. One is called mini macro; second, air pole; strand mount; Magic Box; and femto. These are the new tools that we invented and we created uniquely. Let me explain how it works.

Page 13 on the left-hand side you see macro towers. Of course this is macro tower as good as our competitors with 800 MHz, 1.9 GHz and 2.5 GHz. And on 2.5 GHz we have carrier aggregations and so on to increase the capacity and the speed. But on top of that, in order to increase the better coverage in the in-building and increase also the capacity of the network, we are putting all these tools throughout the towns.

Page 14 we show the example of how our Magic Box will work. Unlike femtocell or typical small cell inside the building, those small cell covers just the indoor. But our new invention is that this Magic Box covers not just the indoor from the inside the building, but also it will cover outdoor into the network, this is our invention. And because we have 2.5 GHz spectrum we can make this happen and we have a new technology called UltraSON, a great name. UltraSON, that is a sales organizing network. With this new technology, the populated, dense number of Magic Box does not interfere each other and we cover indoor but also outdoor over the network. How does it get placed? Page 15 you see the image of the Magic Boxes by the window.

So, we put this box to cover indoor but also outdoor. This box can be connected through the fixed-line broadband with Wi-Fi, or if the household or building does not have those Wi-Fi connectivity, we get the backhaul from our macro towers, wireless. That's a great innovation and does not need any installation, it's fully automated.

On page 16, we show the example. So let's say in the network we put one box inside one building on the left-hand side and then it will shoot our signal to the adjacent buildings and all the neighborhood.

Page 17 is another example. We cover all the neighborhood, the Magic Box not just for indoor, all the neighborhood. So you get connected in your garage, the garden and the street nearby and the household nearby.

So, all of these tools and innovations with our 2.5 GHz spectrum we can differentiate ourselves and create the best network, and we have start testing this deployment very recently into six clusters, New York, San Francisco, Chicago, Denver, Indianapolis and Houston.

As you can see on this page 18, overall performance with the independent neutral party to check by P3, this is an independent party to check the network quality and we get overall number one in New York, San Francisco, Chicago, Denver, Indianapolis. In Houston we are not number one yet, but this is – just we started with all these – six markets cluster. So, not just overall, but you see more detail with web browsing, download and YouTube apps and so on. We feel very proud about this result.

So, you see more detail with page 19, this is the example of New York City in Manhattan Midtown and you can see on the right-hand side with average download speed with Ookla and not just the speed but all the coverage and total performance by P3 checked, this is New York. And San Francisco test area is just on the left-hand side.

You can see the download speed and overall performance, again, we are number one. Chicago, number one also and so on.

As a result I'm proud to say, and confidently I would say, as we have already achieved number one or number two, the voice quality of the network, we will be number one or number two also on LTE data coverage and the speed and the performance. So you will see, and my commitment, you will see the result happening over the next 18 months, 20 months. By the end of next year, we will be number one or number two in most of the market throughout the United States.

But importantly, as management, I will say we don't just waste the CapEx. We don't waste the money. We will make this happen with the lowest CapEx compared to anybody else. As you have seen in the last 12 months, we spent the lowest CapEx among our competitors but we still achieved a great improvement in network with the voice, number one, number two. And data network is coming along very quickly and we are confident and happy to say with all these early test markets, deployment is progressing fantastically. And I will give you the results.

Thank you very much.

Tarek A. Robbiati

Chief Financial Officer, Sprint Corp.

Thank you, Masa. Moving through revenue on slide 23, consolidated net operating revenues of $33.3 billion for the year grew year-over-year for the first time in the last three years. This important milestone of returning to top-line growth is the culmination of three consecutive quarters of year-over-year improvement including wireless operating revenue growing 7% in the fourth quarter.

Wireless service revenue of nearly $24 billion also stabilized as we exited fiscal 2016 and had the lowest year-over-year decline in the last two years. Postpaid service revenue was essentially flat sequentially in the fourth quarter when normalizing for the change to record revenues associated with our device insurance program on a net basis beginning in the fourth quarter as we had foreshadowed for you last quarter.

Similarly, prepaid service revenue was relatively flat sequentially as that business returned to volume growth in the fourth quarter. As a reminder, Sprint changed the terms of its vendor agreement for our device insurance program at the beginning of January which is expected to result in a net savings to the income statement. However, under the terms of the new agreement, Sprint expects to book the insurance program revenue on a net basis and no associated costs compared to the prior program where we recorded the gross revenue from the customers as revenue and the associated expenses in cost of service. As a result, we expected our reported service revenue will be lower by approximately $200 million per quarter as reflected in the fourth quarter and representing the new revenue baseline, while we would expect an even greater reduction in the associated expenses.

Postpaid phone average billings per user was up slightly year-over-year in fiscal year 2016. For the fourth quarter, our postpaid phone average billings per user was relatively flat sequentially when normalizing for the change in recognition for device insurance revenues, which had a roughly $2.50 impact in the quarter. 76% of postpaid device sales were financed for the full fiscal year with 42% being leased compared to 51% of sales being leased in fiscal year 2015. We exited fiscal 2016 with 82% of postpaid sales being financed in the fourth quarter, which includes 86% of postpaid phone sales being financed. I will note that the remaining mix of device activations primarily represent bring-your-own-device transactions for customers electing to pay full price for their device, as we have basically eliminated the traditional subsidy option for all consumer channels.

At the end of the quarter we had 74% of our postpaid phone base on unsubsidized plans with 65% currently having an active device financing commitment as of the end of the quarter. Prepaid ARPU of $28.01 in fiscal year 2016 increased by 1% year-over-year.

Regarding our expenses on side 24, we executed our second consecutive year of significant cost transformation in fiscal year 2016. We realized $2.1 billion in net reductions in operating expenses year-over-year in fiscal year 2016 across cost of services and selling, general and administrative expenses.

This brings our cumulative reductions across these two categories to almost $3.5 billion or an 18% reduction in just two years.

As you may recall from our guidance earlier in the year we did incur over $230 million of one-time cost to achieve these run rate cost savings. As a result, our gross cost reduction in fiscal year 2016 was actually $2.3 billion.

Cost of services for the year of $7.9 billion was down $1.6 billion year-over-year, driven by lower rent with the shutdown of the WiMAX network, lower labor expenses, lower roaming and backhaul expenses and lower wireline costs.

Selling, general, and administrative expenses were $8 million in fiscal year 2016 and improved by nearly $500 million from a year ago, mostly driven by lower customer care and marketing expenses.

Cost of products of $7.1 billion in the year increased by $1.3 billion from a year ago, mostly driven by the significant increase in the installment billing mix of sales from the prior year.

We continue to have good momentum in our cost transformation as we head into fiscal year 2017 and we are already developing initiatives for additional expense reduction in 2018 and beyond.

Now turning to slide 25, our adjusted EBITDA of nearly $10 billion for the year was the highest in nine years and improved by $1.8 billion or 22% compared to a year ago, primarily driven by the expense reductions and the growing operating revenues that I discussed.

Operating income of $1.8 billion for fiscal year 2016 was the highest in 10 years and improved by a multiple of six times from a year ago.

Sprint's net loss in the year was $1.2 billion or $0.30 per share, improved by 40% compared to a net loss of $2 billion or $0.50 per share in the year-ago period.

Turning to slide 26, total cash capital expenditures were $3.9 billion in fiscal year 2016 compared to $7 billion in fiscal year 2015. Excluding capitalized device leases, cash capital expenditures were $2 billion in fiscal year 2016 compared to $4.7 billion in the year-ago period with a year-over-year decline driven by lower capital intensity as a result of software-driven deployments of capacity through carrier aggregation and surgical deployment of small cell.

Net cash provided by operating activities was $4.2 billion for fiscal year 2016 compared to $3.9 billion a year ago.

Adjusted free cash flow was $607 million for fiscal year 2016 compared to a negative $1.4 billion last year.

Shifting focus to liquidity on slide 27, we ended the fiscal year with total general purpose liquidity of $10.9 billion, including $8.3 billion of cash, cash equivalents and short-term investments.

In addition, we still have $1.2 billion in undrawn availability under a network vendor financing facility that can be used to finance the purchases of 2.5 GHz network equipment.

During the quarter we replaced our $3.3 billion unsecured revolving bank credit facility with a new $6 billion secured credit facility consisting of a $4 billion seven-year term loan B and a $2 billion four-year revolving bank credit facility.

This represents the latest example of our strategy to diversify our sources of financing in order to lower our cost of capital and future interest expense. When you combine this with our previously placed $3.5 billion of spectrum-backed notes, we have raised $7.5 billion in two transactions with two things in common: both have an effective interest rate in the mid-3% range, and both transactions were multiple times oversubscribed, demonstrating a renewed demand for Sprint paper as a result of our turnaround execution and improved balance sheet.

Conversely, we have retired $3.3 billion of bonds that matured in the last two quarters, with coupons between 6% to 14.75%, which is a cost of debt two to four times higher than the new money coming in.

Also, as referenced in our 10-Q last quarter, we amended our off-balance sheet receivable facility during the fourth quarter such that all baskets within that facility are now accounted for on balance sheet just as the lease receivables were previously.

With that change, all of our financing is now on balance sheet and hopefully simplifies your understanding and tracking of all our financing obligations. Having diversified our sources of funding and building liquidity, we are now delivering on the second phase which is to materially reduce interest expense.

The third phase is to materially delever the company and reduce our net debt through sustained free cash flow generation.

As we build on a very successful year in fiscal year 2016, let's turn the page to our fiscal year 2017 guidance on slide 28. We expect adjusted EBITDA to be $10.7 billion to $11.2 billion in fiscal year 2017, primarily driven by a continuous focus on significant cost reduction. Given the improved profitability and momentum of the business today we feel we are in the right phase of our turnaround to reinvest a part of our gross expense reduction in 2017 back into growth platforms for the business, including retail distribution, network densification, digitalization of sales and care and prepaid growth initiatives.

Operating income is expected to be between $2 billion to $2.5 billion in fiscal year 2017. We expect non-cash gains from spectrum swaps in fiscal year 2017 similar to the $350 million we recognized in fiscal year 2016. As you know we exclude this non-cash spectrum gain from our adjusted EBITDA, but it does still impact our reported operating income just as it did last year.

Regarding our guidance for cash capital expenditure excluding these devices, we 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 the various cost-efficient coverage and capacity options. We expect network CapEx to remain around this level for the next three years, but could potentially increase if we see the right opportunity to efficiently accelerate our network plan.

Lastly, we're not providing specific guidance on adjusted free cash flow for fiscal year 2017 at this time. However, we do expect adjusted free cash flow to decline year-over-year, primarily driven by the slope of acceleration in capital spending on the network and reinvestment in the business. In addition, we expect working capital headwinds from a higher mix of postpaid sales being financed in fiscal year 2017 with less working capital offset as we transition away from the MNS structure given that more recent sources of capital such as Spectrum LeaseCo are cheaper.

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'll begin the Q&A. Angel, please inform our participants on how to queue up for the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Michael Rollins with Citigroup Investment. Please go ahead.

Michael I. Rollins

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking the questions. Two if I could. First, I was wondering if you could talk about the subscriber performance before Verizon launched Unlimited, and then after? And what kind of changes you observed in the competitive marketplace?

And then secondly, I was just curious if you could also discuss how Sprint looks at the opportunities to prioritize horizontal consolidation in the wireless category at this point versus the opportunities to play maybe into a more vertical strategy? Thanks.

Raul Marcelo Claure

President, Chief Executive Officer & Director, Sprint Corp.

A

Hi Michael, it's Marcelo. Thanks for your question. Now, obviously, the market has turned quite competitive since both Verizon, AT&T and even T-Mobile have basically simplified their offering and make this an unlimited world. Yeah, I think we fared quite well last quarter as you can see from the results. I mean we delivered postpaid adds and net adds to the tune of 42,000 and that was I think 300,000 or 400,000 better than both AT&T and Verizon. So therefore, we've been able to do quite well.

Now, the market has turned more competitive. We continue to generate a significant amount of sales so from a gross add perspective we're faring quite well. And we've always said that as long as we can communicate our value offering to consumers which is having a great network, having a great plan, which is Unlimited, what they like, having the best price, having the best way to own a device I think we're going to do well, and we're going to continue with adding postpaid adds and net adds pretty much every single quarter for the last few years. So we feel quite well.

As it relates to consolidation, there's a lot of talk, as you can imagine, in terms of what sort of consolidations will happen and what role is Sprint going to play. But what we always said since day one is we're focused in terms of creating a great company and turning around Sprint and as you can imagine, I think we're in the right trajectory and we have a lot of options, I believe. And as you will hear Masa say is we're open to potentially doing new acquisitions. We're open to potentially merging the company. We're open to potentially looking if you have interested buyers in the company.

So what we've discussed with Masa is we're open to many different possibilities. Obviously the one that's going to generate the maximum shareholder value is the one that will prevail but make no mistake, I mean the shape of the company, where it's today, it allows us to be very patient. We're sitting on our best liquidity. We've delivered the best financial results of the last 10 years. So we can be very patient and then evaluate whatever opportunity comes our way.

Michael I. Rollins
Analyst, Citigroup Global Markets, Inc.

Q

Thanks very much.

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

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you for taking the question. I wanted to see if I could hone a little bit into cost cutting. You've given more details in the past about how last year you were going to remove a significant amount of costs. You were successful in doing so. Tarek, how, as you look into fiscal 2017, do you view that bogey? Is the low-hanging fruit gone? Where can we see that number go? Could it equal last year's performance, et cetera? Thanks very much.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

Good morning, Jennifer, and thank you for your question. As you can see, we've achieved a pretty substantial amount of cost reductions in fiscal year 2016. We've reduced our cost of service and SG&A for a total amount of $2.1 billion and over the past two years we achieved $3.4 billion of cost reduction, fairly split between these two buckets. As we continue to transform the business, we continue to look at ways to optimize our cost structure in fiscal year 2017. We feel that there is still a fair bit of upside from cost reductions, but we have to balance this with the need to reinvest some of the savings back into the business for future growth.

We're not providing specific guidance on gross and net reductions at this stage for fiscal year 2017 but look at our track record of the past two years, it speaks for itself from our perspective. In terms of telling you a little bit more in a pointed way where to look for, we're going to be optimizing channel mix and distribution. We're going to continue to improve the digital experience so our customers can transact more online with us, which reduces cost in care. And we'll also continue to reduce the cost of the service in the network with backhaul and roaming optimization initiatives to reduce the cost per bit for our company.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you. And one more if I may, just on spectrum, with the auction results now behind you, Masa, you spent a lot of time talking on the network and as you look at how the 600 megahertz auction fared, I guess is there any, regrets is probably too strong a word, but any view of not having enough low-band spectrum? Or are you happy with the 2.5 GHz and the other assets you have? Thank you.

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

A

Right. So, we've been pretty constant in every time we show you that we have the most spectrum of any wireless carrier in the United States and we have more spectrum, I think, than most of the wireless carriers around the world. When we look at what is coming, where 5G is going, and based on the latest 3GPP standard, we are certain that we have the right spectrum, right? I mean, having the vast amount of 2.5 GHz spectrum, as we call the new low band of 5G, I think we're very, very well positioned in terms of continuing to densify our network.

We don't need any more low-band spectrum. We have sufficient national coverage with the low-band spectrum that we have and we did a lot of studying before we decided not to participate in the auction. So even though the prices came wherever they came, we feel that we made the right decision and we're focused right now in terms of continuing to densify our network and continue to provide our customers with a better experience. So we feel quite good in terms of – that we made the right decision. We'd rather invest our money in densifying our network and optimizing our network rather than buying new spectrum that really is not going to be available until 2019 or 2020.

Jennifer M. Fritzsche
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you, Marcelo.

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

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Hi, guys. Thanks. With prepaid and postpaid both stabilizing can you see your way to growing service revenue on a sequential basis, I would think this quarter and in quarters going forward? And then second, Masa, how do you see the regulatory environment for industry consolidation? Thanks.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

Good morning, Phil. Let me take the first question and we'll direct the second question as Masa comes online. Our wireless operating revenue, we're up nearly 5% year-over-year in fiscal year 2016. And when you really look at our wireless services revenue, the decline continues to slow, the decline in the fourth quarter of fiscal year 2016 was off 3.5% roughly year-over-year.

But when you look at normalizing for the changes related to the device insurance program, we were very close to being flat sequentially after this normalization. And the decline is mostly related to customer shifts to plan offered with device financing and also lower prepaid revenues. As the postpaid customer base continues to grow we could see also with the influence of prepaid that we are inches away from the point where service revenue could be growing.

The exact quarter of inflection is not obviously determined. It is somewhat dependent on the device financing mix. But when you really look at the underlying trend, the fact that our prepaid customers are starting to grow again, we feel pretty good about services revenue moving forward.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Thanks, Tarek.

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

Phil, can you repeat your second question?

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Masa, how do you see the regulatory environment in the U.S. for industry consolidation?

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

I believe Masa might have dropped. We're in a different location, he's in San Francisco and we're here. So until he comes back, I'll take it from here.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Thank you.

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

Now, and as we said from the beginning is we'd like to avoid commenting in terms of any rumors as it relates to speculation and others, any rumors as it relates to potential transactions or speculation. Now, I think the new government had made it very clear that they believe in regulating a lot less, and I think people will be open in terms of potential new transactions. Obviously we've been watching what is going on with AT&T and others and I think right now it's too early to tell. I think we're not brave enough to forecast what will be the result of any potential transaction.

So we're like everybody else trying to, looking at different options that sit in front of us and then some will have a higher regulatory risk, some will have a lower regulatory risk and that is part of our entire – when we're looking at any transaction we take that into consideration.

Now, I guess President Trump has made it very clear that he's looking to attract jobs into the United States and anything that you look at any deployment of 5G networks and the potential use cases, I mean tells you that this is going to be a tremendous area of growth for the future of the U.S. And then you have to put that in terms of what would happen in terms of consolidation, whether there would be more jobs created or not. But I mean, right now we say it's too early to tell.

Philip A. Cusick
Analyst, JPMorgan Securities LLC
Q

Thanks. If I could follow up with Tarek just on revenue since you mentioned it, can you expand on the used handset program that drove equipment revenue this quarter? What is this and is it a one-timer or recurring? Thanks again.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

I'm sorry. Phil. Could you repeat your question?

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

The used handset program that drove equipment revenue this quarter, what was that? And is it a one-timer or was that recurring?

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

A

So, we'll take this one.

Masayoshi Son
Chairman, Sprint Corp.

A

Hello. This is Masa. Hello?

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

A

We'll take this one in conjunction with a – Masa, let me take this, Masa, and then there's a question about consolidation. So as it relates to our used phone equipment, what we've done is, we are a leasing company and as you are aware we launched a program called iPhone Forever and in and out the different parts of the year we've launched a product called Galaxy Forever and therefore we are going to get several millions of phones back.

And what we do is we refurbish those devices and then we put them back in the market. We put some into our prepaid brand, we put some others in the auction market. So you can expect on an ongoing basis that we are going to have some additional revenue as it relates to selling used equipment. I mean, that is just part of our business, it is part of any leasing company and we've been doing leasing now for the next two and a half years.

Masa, now that you're on the line the question that you missed was how do you feel about the regulatory environment in the United States now?

Masayoshi Son
Chairman, Sprint Corp.

A

Well, I cannot speak for the government. I'm just hoping that the government is much more open to any kind of possibilities.

Philip A. Cusick
Analyst, JPMorgan Securities LLC

Q

Thank you, Masa.

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

John C. Hodulik
Analyst, UBS Securities LLC

Q

Okay. Thanks. While we have Masa on the phone, a question for you. Could you just talk a little bit about potential partners for Sprint as you look out over the next few years whether within the wireless industry, maybe cable industry or sort of outside more the tech industry, where does sort of wireless fit in as you sort of look at the world going forward?

And then maybe for Tarek, a clarification on the free cash flow comment. It sounds like given the headwind on CapEx and working capital that free cash flow is likely to dip sort of back into the red in fiscal 2017 here. Is that sort of a one year type thing? Or if you could sort of put some boundaries around that, do you see that returning back to – is that true first of all? And then do you see it going back into the black, say, in the following year? Thanks.

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

A

Okay, so....

Masayoshi Son
Chairman, Sprint Corp.

A

Good question to me. I think that there are all kinds of possibilities, and all kinds of opportunities. And we are open to consider any optionalities.

John C. Hodulik
Analyst, UBS Securities LLC

Q

Okay. Maybe I guess, sort of the obvious follow-up in terms of the – Phil brought up the industry consolidation, is that the most attractive potential option for you? And maybe if you could sort of comment on what the potential synergies would be if you're able to sort of engineer a move from 4 to 3 in the wireless industry here in the U.S.?

Masayoshi Son
Chairman, Sprint Corp.

A

Well, we are open to any kind of possibilities, and we can be self-sufficient, so we are not in a rush of anything, but if there are opportunities to consider many different optionalities, we would be very much open-minded. But as I said we are self-sufficient and so we're not in a rush.

John C. Hodulik
Analyst, UBS Securities LLC

Q

Okay.

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

A

And then Tarek will take the second question.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

Okay, so with respect to free cash flow, as I said a moment ago, we're not providing specific guidance for fiscal year 2017 at this time. There are several factors that come into the equation. Mainly, the first one is that we are accelerating capital spending on the network, we are reinvesting in the business also in distribution and other parts of our business. And we do have working capital headwinds from a higher mix of postpaid sales being financed.

Now also on top of that, and you recall from prior earnings announcement that we are transitioning and optimizing how we finance customer receivables and devices away from the MNF structures that served their purpose back in fiscal year 2016, these structures gave us a fair bit of cash advance that we're optimizing for cash, not optimizing for cost of capital. We're moving away from this, we have plenty of liquidity on our balance sheet as we've demonstrated to you today. We are now entering into a new phase where we intend to lower the cost of debt related to how we finance customer receivables and devices in fiscal year 2017.

So all in all, we do not expect our free cash flow, adjusted free cash flow for 2017 to be at the same level of fiscal year 2016, the $600 million that we realized in fiscal year 2016. But we feel good about the trade-offs and we want to make sure that we equip the business for growth for the future.

John C. Hodulik
Analyst, UBS Securities LLC

Q

Great. Thanks, Tarek.

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

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thank you very much and good morning, folks. I was wondering, there have been some reports that suggested that you folks are examining potential options around ensuring your spectrum value is not under-representative, such as a possible spinco or something along those lines. First and foremost, is that the case? And secondly, and probably more importantly, what do you believe is not understood about your spectrum and its value, not just for 4G networks but as well as for 5G networks?

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

A

So as it relates to your first question, a potential spectrum spinco, I mean, as you can imagine we're not going to comment on anything like that. There's all sorts of speculation in terms of what we're doing with our spectrum and others, but we will never comment on something like that. As it relates to our 2.5 GHz, I'm going to let John Saw basically take that question.

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

A

Hey, Amir, I think the 2.5 GHz spectrum has long suffered under the stigma that high band spectrum may not be available as low band spectrum, but that was based on some old thinking in the old days where coverage matters more.

In a data-centric world where capacity is more important than anything else, high-band spectrum thrives. And that's why you see the play for more and more high band spectrum in the industry today, including the play for even higher band spectrum than 2.5 GHz spectrum.

In a matter of the last two years the 2.5 GHz spectrum has dramatically improved in terms of its usage. It is one of the world's largest global ecosystems today for LTE where more than 600 million phones have been shipped globally with the 2.5 GHz spectrum band in it.

So in the rapid growth in the 2.5 GHz spectrum we don't believe that the valuation for this band has caught up with it. I think Tarek and team has done an awesome job when we did the Spectrum LeaseCo in terms of trying to put some value to that.

We believe that the 2.5 GHz spectrum, we have yet to see the best in the 2.5 GHz spectrum yet. When you talk about 5G, when you have to deliver massive capacity and yet have good propagation characteristics that is better than millimeter wave, 2.5 GHz is going to be hitting the sweet spot.

So what we're building is the foundation and we've done a good job putting that to good use the last two years. I think you have yet to see the best of 2.5 gig, when we start rolling out our 5G-type services in the gigabit range.

Amir Rozwadowski Q
Analyst, Barclays Capital, Inc.

Great. Thanks very much. And just one follow-up if I may. Tarek, forgive me if I'm paraphrasing, but I believe in a prior appearance you mentioned that Unlimited at current pricing levels is not really sustainable over the longer term.

I was wondering if you could provide us with some color on your thought process here, do you think that there's an opportunity for the industry to revisit pricing and how should we think about Sprint's own pricing strategy going forward from here?

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

Yeah, it's a great question. I think you know when I said that Unlimited is not sustainable is – I quantified it by saying absent the ability to change price. Of course, as you cap your revenue and your capacity utilization increases due to usage doubling every 18 months that we've witnessed in our industry, that sort of combination of trends is not sustainable but we always have the option to increase prices.

So I think over time you would see that the peace of mind that unlimited pricing provides to customers will be effectively valued and we see scope for price increases over time.

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

Let me add one more thing. Since we have moved to Unlimited, our average billings per user have constantly been increasing. So therefore when you look at our previous pricing in which we were doing 50% off or cut your bill in half, our price, and now we've moved to one rate plan which is Unlimited Freedom, our average billing per user has increased and will continue to increase.

So as long as we can keep that trajectory and as data usage continues to increase and we're able to get the right price from our customers, we're going to continue to see an increase in our revenue. So that's why Unlimited is a good thing for Sprint.

And secondlys nlimited is exactly the game that we want to play now when you have the quantity of 2.5 GHz spectrum. I don't know how other carriers are going to do it as it relates to the spectrum that they have. We've been in the past, I don't know if you remember, certain carriers have serious problems in markets like New York City once they had Unlimited. So the two large major carriers went out of their way for four years to basically kick every customer out of their network that had Unlimited, that was because they were suffering from capacity issues.

To us, it is a complete opposite. I mean, we like Unlimited because it's right up our sweet spot. When you're holding over 200 MHz of spectrum you want to play the Unlimited game because capacity is basically your competitive advantage.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thanks for the additional color.

Masayoshi Son
Chairman, Sprint Corp.

A

Let me add a little bit on top of that. So, I welcome the Unlimited war because other carriers don't have the spectrum. Not only that, the other carrier don't have 2.5 GHz. So what we can do is with the 2.5 GHz, we, as I presented, we will have millions of cell sites. When you have the spectrum and millions of cell sites, that increase the capacity dramatically.

So, no other carrier can keep up with the capacity war and we have the spectrum and 2.5 GHz enable us to do these small cells in a dramatic deployment. This is unheard of. This is the revolutionary network. So that the other carriers, please come to this capacity war.

Amir Rozwadowski
Analyst, Barclays Capital, Inc.

Q

Thank you for the additional color, Masa.

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

A

Operator, can we get our next question, please?

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

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

Q

Thanks. Two questions. So, first on the comment that the network should be number one and number two in some markets, what kind of improvements do you think we should expect to see, either churn, ARPU, perhaps market share? Just if you could help us think through some of the tangible benefits of that, that would be great. And my second question is I know it's early days on HPUE but what's been sort of the initial customer feedback on that particular handset? Thank you.

Tarek A. Robbiati
Chief Financial Officer, Sprint Corp.

A

Thank you. So, I'll take it from a network and I want everybody to understand what our strategy has been. So if you listen to the earnings presentation, the network part that Masa gave, what we've done is we've developed a pretty amazing toolbox that allows us to rapid deployment of the network.

So what we've done is we've selected six clusters in the U.S. in different markets like New York, San Francisco and others and we basically tested in those clusters what would our network look in comparison to our competitors? And we've hired third-party companies to basically come and do the testing. And in each of those clusters, or network, once we've been able to deploy our mini macros or small cells, or better known as Magic Box, then we automatically move to number one in every single one of those clusters.

So now the next phase is grab those clusters and replicate a cluster into a bigger market till you are able to achieve an undisputable number one in terms of speed, in terms of coverage, in terms of capacity, which are the things that matter. Now, once you've been able to achieve that, then the world looks a little bit different. Then you don't have to discount as much as we've had to discount in the past. Now you've seen that we've had to discount a lot less in the course of this last quarter where we don't need for a bill to be 50% of competitors'.

We're getting close to what AT&T, Verizon and T-Mobile charge and therefore you can expect an increase in ARPU going forward as our network continues to achieve number one in different markets. So we feel quite good. It's not just a technological experiment. We actually deploy in pretty large clusters and we have the tests that validate that our network becomes number one in every single one of those clusters once we deploy our technology. And the good thing is this is really fast to deploy, due to the fact that's predicated on our small cells.

Now, your second question was what have we seen on HPUE. I'm going to let John Saw answer that and Masa can jump in if he sees fit. Go ahead, John.

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

A

Hello, Amy. I think it's still too early to gauge customer perception of HPUE. We do know that from the tests that we've done in the lab, the 30% coverage extension that we're hoping to see, we are seeing that in the lab. I think the customer, what they will experience is probably higher capacity and better speeds on 2.5 GHz and staying on 2.5 GHz a lot longer before their phones have to fall back to 1.9 GHz. But we will have to wait and see as we get more and more phones out there with HPUE but testing in the lab so far looks very encouraging.

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

Q

Thank you.

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

A

So, that's all the time we have for questions today. Before we wrap up, I'd like to turn the call back to Marcelo for a few closing comments.

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

Thank you. I want to thank everyone for joining us today and for your support of Sprint. Our fiscal 2016 results demonstrate the strong momentum we have built over the first half of our five-year turnaround plan. We have returned the business to revenue growth and we've taken out $3.5 billion of costs in just two years to deliver our highest adjusted EBITDA in nine years and our highest operating income in ten years. We deliver 930,000 postpaid phone net adds last year and return our prepaid business to growth as we exited the year.

In addition, we continue to improve the network by executing our densification and optimization plan in a very capital-efficient manner. We look forward to deploying our unique toolbox including the Magic Box across the country to make our network even better. We're excited to carry our momentum forward to deliver more shareholder value in 2017, 2018 and beyond.

Lastly, I want to spend a moment telling you about an important initiative that myself and the entire Sprint organization is passionate about. Last year we announced the 1Million project and the reason why we did that is because there are five million families with school-aged children in this country who cannot afford internet access at home. That puts the students at a major disadvantage in doing their schoolwork and competing to get a first shot at graduating high school and being successful in life.

Over the next five years, we're going to give away 1 million low-income high school students a free device and a free wireless service so they can learn to study at home. This initiative is cost-neutral to Sprint as we're raising money from our different partners and others to pay for it. I'm pleased to say we made enormous progress on this important cause. At the beginning of the 2017/2018 school year the first 200,000 students in 800 schools across America will begin participating in this program. You can learn more or contribute to this effort by going to our website www.sprint.com/1millionproject. Thank you and have a great day.