

30-Jul-2014

Sprint Corp. (S)

Q1 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Kristy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Sprint fiscal first quarter earnings conference call. After the speakers' remarks there will be a question and answer session. Thank you. Mr. Brad Hampton, VP of Investor Relations, you may begin your conference.

Brad Hampton
Vice President-Investor Relations

Thank you, Kristy. Good morning, everyone, and welcome to Sprint's quarterly earnings call. On today's call, Dan Hesse will discuss operational performance in the quarter. John Saw will provide an update on the network, then Joe Euteneuer will cover financial results. After that we will open up the call to your questions. Before we get under way, let me remind you that our release, quarterly investor update, and presentation slides that accompany this call are all available on the Investor Relations page of the Sprint website.

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, including our annual and quarterly reports.

Turning to slide 3, throughout our call we will refer to several non-GAAP metrics. Reconciliations of our non-GAAP performance and liquidity measures to the appropriate GAAP measures for the quarter can be found in the

attachments to our earnings release and also at the end of today's presentation, which are available on our website at www.sprint.com/investors.

Let's move on to our earnings results on slide 4, please. Financial results include a predecessor period for the second calendar quarter of 2013 related to the results of operations of Sprint Communications Incorporated, formerly Sprint Nextel, prior to the closing of the SoftBank transaction on July 10, 2013, and the applicable successor periods. In order to present financial results in a way that offers investors a more meaningful comparison of the year-over-year quarterly results, we have combined the second calendar quarter 2013 results of operations for the predecessor and successor periods. The following remarks relating to second quarter calendar of 2013 are in reference to an unaudited combined period unless otherwise noted. Trended financial performance metrics on a combined basis can also be found at our Investor Relations website at sprint.com/investors.

As announced earlier this year, Sprint changed its fiscal year-end to March 31, making this our first fiscal quarter of 2014. However, for ease of comparison to prior periods, any references to the first quarter ended June 30, 2014, on today's call will be referred to as our second calendar quarter.

Net income for the quarter was \$23 million, compared to a net loss of approximately \$151 million last quarter and \$1.7 billion in the second quarter of 2013. Total depreciation and amortization was approximately \$1.3 billion for the quarter, consistent with last quarter, and compared to \$1.6 billion in the year-ago period. As you may recall, 2013 included accelerated depreciation, primarily related to the shutdown of the Nextel network and certain legacy 3G equipment. We had a net tax benefit of \$15 million in the quarter, due to a decrease in valuation allowance on deferred tax assets resulting from the planned disposition of certain FCC licenses. We expect net tax expense of \$140 million to \$180 million for the calendar year. Lastly, although Clearwire's financial results are now consolidated with Sprint's and included in today's presentation, its stand-alone quarterly financial results will be available on our website in the next several weeks, as required by its debt covenants.

I will now turn the call over to Sprint CEO Dan Hesse.

Daniel R. Hesse

Chief Executive Officer

Thanks, Brad. We appreciate everyone joining us this morning. Thanks for your interest in Sprint.

Let me start by touching on the operational highlights of the quarter. Turning to slide 6, our net income of \$23 million for the quarter represents our best performance in almost seven years, excluding the one-time non-cash transaction-related impacts reported last year. Adjusted EBITDA of \$1.83 billion represents growth of 30% year over year, and our adjusted EBITDA margin of almost 20% is up over 6 percentage points compared last year, our largest year-over-year growth on record. This marks the 12th consecutive quarter we've exceeded or matched the Street consensus expectation for adjusted EBITDA.

I'm pleased to report we hit all of the key network deployment midyear targets. Sprint LTE service now reaches 254 million people. The multiyear rip and replacement of our core voice and 3G platform is now largely complete, and HD voice service is now available nationwide. Given our strong HD voice call quality and continued improvements in the customer experience – including network performance, which John will discuss later – we recently reinstituted the Sprint Satisfaction Guarantee, the opportunity for customers to try Sprint for 30 days, worry-free. Finally, in keeping with our track of innovation, during the quarter we launched exclusive new devices in mobile content in new two high-demand consumer lifestyle segments, music and fitness.

I'll focus the balance of my remarks this morning on our unchanging priorities: generating cash, improving the customer experience, and strengthening the brand. Please turn to slide 7. We ended the second quarter with cash, cash equivalents, and short-term investments of \$5.5 billion. We delivered operating income of \$519 million, our second consecutive quarter of positive operating income and our best operating income performance for any quarter in over seven years. Joe will take you through the drivers of our adjusted EBITDA performance shortly, but as we've discussed with you in recent quarters, we remain focused on cost management and driving efficiency in the business, even as we fund sizable investments in our network. We've made notable year-over-year progress in reduce is expenses in areas like customer care, selling expenses, and roaming expenses, contributing to wireless adjusted EBITDA growth of almost 40% year over year and service margin of over 25%. This represents an almost 8 percentage point increase in wireless adjusted EBITDA margin over the year-ago quarter.

Please turn to slide 8 and the customer experience. We continue to set performance records in our customer care operations. I'm pleased to report that in 2014's American Customer Satisfaction Index released in May, Sprint is the most improved U.S. company in overall customer satisfaction across all 43 industries over the last six years. The second quarter represents our 22nd consecutive quarter of improved performance and lower costs in customer care. In our post-paid business, calls per customer to care and care credits granted to customers were both again best-ever levels. And each improved on a year-over-year basis for the 22nd consecutive quarter.

Turning to slide 9, as I've discussed in detail on the last couple of calls, and as expected, our post-paid churn continues to be elevated as we work through the significant construction impacts associated with the rip and replacement of our entire 3G and voice network. This intense network overhaul impacts the performance of our voice and data service while the infrastructure is being replaced and thus negatively impacts our customers' experience, which we had improved from industry-worst to industry-best levels before the construction began. The impact to the voice call experience is the largest driver of the elevated churn we're experiencing during the construction.

As I discussed last quarter, churn elevates during the construction period but begins to stabilize once we reach 70% complete with the voice and 3G replacement in a market. Market level churn improvements correlate strongly with the number of months that market has been 70% or more complete. For example, consistent with what I reported to you last quarter, in markets where we've been 70% or more complete for seven months or longer, consumer voluntary churn in the second quarter was 14 basis points lower than markets 70% complete for fewer than seven months. The typical customer makes or receives 80% of their calls on their top five towers. For markets 70% complete for seven to 10 months, customers with their five top towers complete had six additional basis point of churn improvement. Customers with their top towers complete in markets 10 months or more after hitting 70% complete saw another 16 basis points of churn improvement, or 36 basis points in lower voluntary churn than customers in markets 70% complete for less than seven months. This gives us the confidence that voluntary churn will eventually go below pre-Network Vision project levels.

In just a few minutes, John will share with you the substantial progress we're seeing in our network performance. Given the progress on our network, we continue to expect improvement in consumer voluntary churn in the second half of the calendar year and beyond. Current trends for the third quarter indicate we could see our best second to third quarter sequential voluntary churn improvement on record. Over the last five-plus years, we've experienced an average seasonal churn increase of approximately 20 basis points from the second to the third quarter. By sequentially reducing voluntary churn, we now expect to mitigate half of that normal seasonal increase as we look to the third quarter. And we would expect further improvement in the fourth quarter as customers have more time to experience improved network performance.

Please turn to slide 10. Sprint's platform gross adds were up 16% on a year-over-year basis. And in spite of our network headwinds, we estimate we held our post-paid share of gross adds roughly flat sequentially. We innovate

relentlessly at Sprint. We're granted an average of over two U.S. patents every business day. We focus our innovation across five major platforms: technology, markets, content, services, and corporate responsibility. And today I'd like to update you briefly on two of these areas.

Please turn to slide 11. Sprint Spark is our key technology innovation platform. Among the five elements that make Spark such a powerful network evolution platform – 8 transmit 8 receive at the base station, which we demonstrated for many of you in Chicago in June; [ph] 4x2 downloading in multiple how don (12:05) devices; time-division duplex LTE; and tri-mode high-definition voice-capable devices – the most powerful differentiator is fully utilizing the deep spectrum resources acquired with Clearwire via 3x carrier aggregation. As previously announced, we expect 2x carrier aggregation capable devices with peak speeds in excess of 100 megabits per second once we turn up 2x in the network later this year, but even faster will be 3x carrier aggregation. I'm pleased to announce that, leveraging our strong relationship with Qualcomm, we are accelerating availability of 3x carrier aggregation capable handsets from the second half of 2015 to the first half of 2015. 3x carrier aggregation should give us peak data speeds in excess of 150 megabits per second to the device. Pre-seeding as many 3x capable devices in the first half of 2015 with customers, in advance of turning 3x capabilities on in our network, will allow us to bring these capabilities to far more customers when 3x is activated in our network late in 2015.

Please turn to slide 12. Content is another innovation platform. During the second quarter, we announced and rolled out content in the key consumer lifestyle segments of music and fitness. In music, the launch of our exclusive agreements with Spotify and HDtracks, paired with the groundbreaking HTC One M8 Harman/Kardon edition bring an unprecedented high-quality audio experience to smartphones.

In fitness, we launched a collaboration with Under Armour to add even more utility to Sprint's exclusive Samsung GS 5 Sport handsets. Family penetration continues to grow, and we believe our rates could be more competitive in certain segments. We are currently testing a number of new price plans so that we can choose price structures which could be the most effective for a possible future rate plan refresh. As we assess the heightened post-paid competitive environment, any changes to our competitive positioning will be balanced with our focus on growing long-term shareholder value. A test period will give us time to make even more network progress as we prepare for the peak selling period in the fourth quarter. Given the churn improvements we're experiencing, we now expect to achieve post-paid net subscriber growth in the fourth quarter of the year.

I'm also pleased to announce another service innovation that will change the way Americans buy prepaid wireless. If you turn to slide 13, today we are launching Virgin Mobile Custom, a fully customizable, no-contract plan with rich parental controls, which we will offer exclusively at Walmart. Virgin Mobile Custom allows customers to build their own individually tailored plans. Customers can choose from a wide range of texting, calling, and data options to build plans that suit their individual needs. And customers are able to change their plan anytime, directly from the device, helping them manage their wireless spend and only pay for what they need. The technology platform from ItsOn enables the most comprehensive parental controls available, setting curfews for texting, limits for surfing, or blocking of any sites. Immediately following our call today, we have a video available on our IR website that demonstrates the benefits of this innovative offering. I strongly encourage you to take a look.

In conclusion, on slide 14, we produced yet another strong earnings improvement quarter and customer service improvement quarter. We've launched innovative Family offers with new partners like Harman and Spotify music and with Under Armour in fitness. We've met our LTE build targets and launched HD voice and the Sprint guarantee nationally. We demonstrated Sprint Sparks' innovative 8T8R radios in action, and we're accelerating the timetable for 3x carrier aggregation capability in devices. Our senior team has recently visited 14 of our markets together. Even though the complete rip and replacement of the network has been a difficult experience for them and for their customers, our people could not be more enthusiastic about our recent network progress

and for selling Sprint services. One of my teammates who accompanied me on these visits is our Chief Network Officer John Saw, who will now discuss our network progress. John?

John Saw

Chief Network Officer

Thank you, Dan. I'm pleased to be with you today to discuss our significant progress on America's newest network.

As Dan mentioned, we delivered on our three key milestones for midyear. We are now substantially complete with the rip and replacement of our legacy voice and 3G network. In addition, we beat our 4G LTE commitment to cover more than 250 million POPs by the end of June and now cover approximately 254 million LTE POPs. We also delivered nationwide availability of high-definition or HD voice by midyear, with over 40% of our post-paid base currently on HD voice-enabled handsets.

Building an entirely new network from the ground up has been a challenging task. But we now have a strong foundation to innovate on and to bring more capabilities and services to our customers. With a completely new platform in place, we're now shifting our focus to three key priorities. Firstly, we will enhance our voice coverage by continuing to add more 800-megahertz to our footprint. Secondly, we will strengthen our LTE service with improved coverage of 800-megahertz LTE and higher speeds and capacity with our 2.5-gigahertz LTE builds. Thirdly, we will relentlessly focus on network quality and optimization to ensure an optimal experience for all our customers. In the past few months, we have doubled down on our efforts to improve on our customers' experience on our network. We are focusing more resources in the field, where our engineers are working individual cell site by cell site to ensure that they are all performing at optimum levels. Our goal is not only to deliver the best-ever performance for our customers, but to ultimately deliver best-in-class performance for them. We are beginning to see the fruits of our labor.

Turning to slide 17, as I mentioned last quarter, we are seeing significant improvement in voice blocks and drops as we upgrade the 1.9-gigahertz network to the latest technology and equipment. We also now have roughly two-thirds of our voice footprint turned up on 800 megahertz and expect the deployment of voice on 800 megahertz to be substantially complete by the end of the year in markets where spectrum rebanding is finished. When you consider that over 60% of our post-paid base is on 800-megahertz voice-enabled handsets, this has an immediate benefit to our base as we turn up more 800 megahertz.

The icing on the cake is the launch of our nationwide HD voice service. So not only should our customers expect to have better voice performance, but also exceptional voice quality and clarity. We are delighted that Sprint has the most improved voice network in 14 major markets, including New York and Chicago, based on independent third-party testing of dropped and blocked call performance over the past few months.

Shifting gears to data. I am pleased with the team for expanding our LTE footprint to more than 250 million people by the end of the quarter, as it gives us a good foundation to build on as we expand the Sprint Spark experience. Sprint Spark is currently in 27 markets, and we have 22 Sprint Spark-capable devices in market. We continue to expect to cover 100 million people with LTE on the 2.5-gigahertz band by the end of the year. And we are excited to have begun the installation of 8 transmit 8 receive, or 8T8R, radios, which should significantly improve the coverage and speeds of our 2.5-gigahertz TDD-LTE service. By the end of the year, we expect to have capabilities for two-channel carrier aggregation in the 2.5-gigahertz spectrum band, giving us added capacity and even faster data speeds. In addition, we continue to make good progress on the deployment of LTE on 800 megahertz, which now reaches more than one-third of our footprint.

Sprint Spark also received the 2014 Light Reading Leading Lights award for most innovative 4G service. Just as encouraging is the significant improvement in data performance over the last quarter, as independent third-party testing showed sequential improvement in our data performance.

In addition, you can see in slide 18 that RootMetrics' testing at O'Hare International Airport in Chicago showed a significant 20 times improvement in Sprint's LTE speeds between their test in September 2013 and the latest test in May 2014. This is the Sprint Spark experience that we want to replicate nationwide.

Also, in the following slide on page 19, our own internal benchmarking shows Sprint as having the most improved data connection rates in the past three months. Our focus on quality and optimization also applies to our capital spending as we reevaluate where our resources are focused while we wind down the Network Vision build. We're also leveraging SoftBank and our vendors to collaborate on ways to deploy the network on a more capital-efficient basis. By moving more traffic to our expanded LTE footprint, we are also able to spend less on 3G capacity than we had planned.

Our network is never done. But we are excited about the improved performance our customers are experiencing as we shift our attention to the evolution and optimization of our multi-band platform. Our commitment to continuously improve our network means fewer dropped calls and a better broadband data experience for our customers.

I will now turn it over to Joe to take you through the financials.

Joseph J. Euteneuer

Chief Financial Officer

Thank you, John. Good morning, everyone. We continue the momentum in margin improvements, as Dan mentioned, leading to higher operating profits and net income. We remain committed to improving the efficiency of our wireless business and driving cost out as we continue to invest for future growth.

Moving to slide 21, Sprint platform post-paid net subscriber losses were 181,000 in the quarter, driven by elevated churn levels. Sprint platform post-paid churn was 2.05% in the quarter, down from 2.11% last quarter but up from 1.83% a year ago, as we continued to experience network headwinds in a competitive retail market. We added 535,000 post-paid tablets in the quarter, as we continued to grow existing accounts in our base, offset by declines in handset customers of 646,000 and other mobile broadband customers of 70,000.

In the quarter, 7.2% of our Sprint platform post-paid base upgraded devices, in line with last quarter. Smartphones represented 94% of post-paid handset sales in the quarter and now account for 84% of our post-paid handset base. In addition, we now have over 55% of our Sprint platform post-paid base on LTE devices, including over 66% of our Sprint platform post-paid smartphone base being on LTE devices. Also, 28% of all post-paid devices sold in the quarter selected the installment billing option, remaining relatively flat to last quarter.

As we foreshadowed last quarter, Sprint platform prepaid experienced net losses of 542,000 customers in the quarter, primarily related to Assurance due to recertification of the base and growth impacted by the recent implementation of the National Lifeline Accountability Database. It has had a negative impact on the gross adds and will likely temper the growth of this program, not only for us but also for the industry going forward. We are pleased with the growth of Boost and the response to the new rate plans. In fact, Boost had the highest-ever gross adds on the Sprint platform since it launched in 2007. Wholesale and affiliate net additions of 503,000 were primarily driven by connected devices and marks the fourth consecutive quarter of growth in this business.

Moving to revenue, wireless service revenue of \$7.1 billion was down sequentially and year over year, as continued declines in post-paid service revenues were only partially offset by increases in wholesale revenues. However, wireless operating revenues remained relatively flat year over year, as the introduction of installment billing shifted revenues from service revenue to equipment revenue. Sprint platform post-paid ARPU was \$62.07 in the quarter, compared to \$63.52 last quarter and \$64.20 a year ago. The declines are primarily driven by higher tablet mix in the base, as well as migration to Family plans, partially offset by lower customer discounts and credits and higher revenues from our handset insurance products. However, it is important to note, for comparability purposes, if you add monthly equipment billings, then the equivalent Sprint platform ARPU would be down only 1% year over year. Sprint platform prepaid ARPU of \$27.38 grew 4% sequentially and 2% year over year, as the base mix shifts to the higher-ARPU Boost and Virgin brands.

Wireline revenues declined 3% sequentially, driven by international revenues, while the 18% decline year over year was a result of our cable voice over IP migrations, voice volume declines, and the annual intercompany rate refresh, with the intercompany impact being neutral to consolidated adjusted EBITDA.

Please turn to slide 22. Consolidated adjusted EBITDA of \$1.83 billion was up \$425 million from the year-ago period and flat sequentially. The year-over-year increase is driven by the continued improvement in our wireless adjusted EBITDA of \$1.7 billion, which improved by nearly \$500 million, posting margins over 25% for the second consecutive quarter. Sequentially, the net benefit to EBITDA from installment billing was less than last quarter, as the impact to equipment revenue was flat on a consistent mix in volume, while there was a cumulative impact to service revenues and bad debt. The expansion of wireless adjusted EBITDA margins is partially offset by wireline adjusted EBITDA, which declined year over year to \$35 million, again driven by migrations and the annual intercompany rate refresh, which is neutral to consolidated adjusted EBITDA.

Consolidated operating income of \$519 million was up 24% sequentially and improved by more than \$1.4 billion year over year. The year-over-year improvement is due to the significant improvement in EBITDA, as I just mentioned, as well as lower depreciation expense, as the year-ago period included accelerated depreciation related to iDEN and legacy CDMA.

Moving to slide 23, wireless equipment net subsidy in the quarter was \$1.1 billion, which remained relatively flat sequentially. Year-over-year net subsidy improved \$426 million, as equipment revenue was up \$286 million year over year, primarily due to the introduction of installment billing for devices, while cost of products was down \$140 million, mostly due to a higher mix of tablet sales and lower volumes. As we discussed last quarter, under Sprint Easy Pay, customers are billed for their device over 24 months, and we recognize the equipment revenue less the imputed interest at the same time as the expense.

Wireless cost of service of \$2 billion improved \$243 million year over year, primarily due to the elimination of network expenses related to the Nextel platform, lower roaming expenses, and lower backhaul expenses, partially offset by the net impact of the Clearwire acquisition. Sequentially, wireless cost of service improved \$57 million, primarily as a result of lower network modernization spend, including backhaul savings as we continued migration to Ethernet and eliminated T1s.

Wireless SG&A expenses of \$2.2 billion improved \$101 million year over year and improved \$80 million sequentially. The improvements were driven by continued reduction in [ph] care (31:34) expenses through operational efficiency, lower selling expenses, and lower marketing spend, partially offset by higher bad debt expense. The lower selling expense are a result of continued streamlining of the sales organization, as well as improved channel mix and lower average commission rates due to device mix. The increase in bad debt primarily reflects the impact of increased accounts receivable associated with subscribers who have elected to finance the purchase of their device through our installment billing program.

Moving to slide 24, we ended the quarter with a total liquidity position of \$9.1 billion, including cash and cash equivalents and short-term investments of \$5.5 billion and \$2.4 billion of undrawn borrowing capacity under our revolving bank credit facility. During the quarter, we entered into a facility to sell certain accounts receivable. The amount and eligibility of salable receivables will vary over time and was approximately \$1.2 billion at the end of the quarter. We had not drawn upon the facility as of the end of the quarter, but this facility will provide additional diversity of future funding sources. As we look ahead, we have no significant maturities due until December of 2016.

Capital expenditures of just over \$1.4 billion in the quarter were up \$359 million sequentially, primarily related to growing momentum of the 2.5-gigahertz build. Year-over-year capital expenditures are down \$481 million. For the same quarter last year, the Network Vision program was the lion's share of the capital program, as deployment was accelerating. This year's spending on network modernization has been lower, as spend for construction has wound down as we approached our originally planned deployment targets. Partially offsetting this decrease is higher spending on Sprint Spark deployments. Our capital spend is expected to increase in the second half of the year as we continue to invest in LTE capacity by expanding LTE on 800-megahertz and 2.5-gigahertz spectrum to enhance the customer experience.

Free cash flow was negative \$496 million for the quarter, compared to negative \$396 million for the year-ago period and negative \$1.1 billion last quarter. The year-over-year decline was due to higher working capital spend, offset by higher EBITDA and lower CapEx. Sequentially, the improvement is related to higher cash from operations, decreased cash paid for CapEx, and favorable expenditures related to SEC licenses due to a one-time refund of rebanding cost. Within working capital, we did have \$610 million included in accounts and notes receivable related to installment billing. Total net receivables related to installment billing were \$981 million, up from \$616 million at the end of last quarter.

Now I'd like to provide an update on our guidance for calendar year 2014. We have made significant year-over-year improvement in our adjusted EBITDA margins in the first half of this year and expect to continue our disciplined approach of taking additional costs out of the business in the back half of this year, as well as seeing the financial benefits of network modernization. However, the gains in our core wireless margins are partially offset by the expected decline in wireline adjusted EBITDA in the second half of this year.

We have delivered year-over-year growth in organic wireless EBITDA of nearly 20% in the first half of this calendar year, excluding any benefits from installment billing. We are maintaining our expected calendar year 2014 consolidated adjusted EBITDA of between \$6.7 billion and \$6.9 billion, but as Dan mentioned, we are closely evaluating the competitive landscape and are positioning in light of our goal to be post-paid net-add positive in the fourth quarter. While this adjusted EBITDA guidance doesn't assume a change in our post-paid rate card for this year, any proposed changes would be made only after evaluating our market test results and determining that they should be long-term accretive for the business. Finally, based on the projected depreciation and amortization expenses for the balance of the year, we expect to continue to generate positive operating income in 2014.

From a capital perspective, we are wrapping up the rip-and-replace activity and shifting our focus on the expansion of the Sprint Spark throughout the year, with the 2.5-gigahertz LTE overlays being weighted to the second half. This migration of data traffic to LTE is allowing for less investment in 3G capacity than we had originally planned. With the laser focus on deploying Sprint Spark and the optimization of the network, as well as the close working relationship with SoftBank, we are seeing greater efficiency in our capital spending, including lower rates on equipment. As a result, we now expect our calendar year 2014 capital expenditures to be below \$7 billion. However, let me underscore that our expected spending on the 800-megahertz and the 2.5-gigahertz

deployments remains unchanged, and John and his team remain committed to meeting or exceeding our original deployment targets for this year.

I'm proud of what the Sprint team has been able to accomplish in the first half of this year, but there's still more work to do. And I am confident that with their continued hard work and dedication, we'll continue to make progress. I'll now turn the call over – back to Brad for Q&A.

Brad Hampton

Vice President-Investor Relations

Thanks, Joe. In just a moment, we will begin the Q&A. Kristy, can you please inform our participants on how to queue up for the question and answer session?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]

Brad Hampton

Vice President-Investor Relations

Okay, Kristy, we're ready to begin the Q&A.

Operator: Your first question is going to be from the line of Kevin Smithen with Macquarie.

Kevin Smithen

Macquarie Capital (USA), Inc.

Thanks. Dan, quick question. Obviously SoftBank announced Nikesh Arora would be joining to run SoftBank North America. How do you envision him interfacing with Sprint? What's the reporting structure for you and Joe, and what does Nikesh bring to the table here?

Daniel R. Hesse

Chief Executive Officer

Thanks for the question, Kevin. I haven't talked to Nikesh since his new role has been announced. There is no reporting relationship, if you will, to SoftBank other than their designees to the Sprint board. And to my knowledge they have no plans to make any changes there. But we look forward to talking and working with Nikesh as a member of the SoftBank team going forward.

Kevin Smithen

Macquarie Capital (USA), Inc.

And then there's been a lot of discussion on your pricing and your potential need to reprice. How do you think about your different buckets of subscribers and where you think you're competitive on pricing and where you think you might have to make pricing adjustments to be competitive with the current sort of T-Mo and AT&T offerings?

Daniel R. Hesse

Chief Executive Officer

Well, it's why we're doing trials right now. But, basically, since we launched the Framily plan back in January, there have been a number of competitive moves. So Framily was quite competitive at that time. It's become less competitive at certain line levels. So we're testing some options out there. It's too early to have any results from those trials, but we're going to learn from those trials, and we haven't made any decisions yet, but we may need to make some adjustments to our pricing levels based upon what we learn.

Operator: Your next question is from the line of Amir Rozwadowski with Barclays.

Amir Rozwadowski

Barclays Capital, Inc.

Thank you very much. Two questions from my side, if possible. Dan, just following up on the potential adjustment for pricing, I guess, from my perspective, how should we think about sort of the tiering of some of your pricing plans? I mean, it does seem as though you have the pieces in place from a network perspective where you feel comfortable competing with what's available vis-à-vis your competitors. But, of course, you folks have always maintained sort of the unlimited plan as a core differentiator for you going into the marketplace. So how should we think about how you plan to approach that strategy?

Daniel R. Hesse

Chief Executive Officer

Well, actually, those are part of our tests. We're testing, if you will, unlimited plans and plans that are not unlimited. And we'll learn more. But it seems as though, over the years, as we do market research, unlimited has strong appeal. So again I'm not making any declarations here. We're going to wait for the results of the trials, but I would be very surprised if we did not continue to have unlimited offers in addition to – we'll call them metered offers, because that is a differentiator of Sprint. It's a place that we really stand out in terms of customer perception, and unlimited is something of very high value. If you actually even look at our advertising, you've probably noticed that the unlimited message is becoming more prominent in our advertising versus let's say a lower-cost tiered option, because we find the unlimited message continues to resonate with customers.

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

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Great. Thank you for taking the question. These are probably more for Dr. Saw. I just had two quick questions on the network. Right now you're working off 5x5 channel. Am I correct in saying that when a Spark market is launched, you immediately have access to that 20x20 – the first 20x20 channel for those handsets that have the 2.5 GHz chip? And then, when you say 60% of your base is on voice-enabled 800-megahertz handsets, as you light those up, is that just a seamless – they're basically plug and play, they're immediately usable? If you can confirm that.

John Saw

Chief Network Officer

Hey, Jennifer. Yeah, I'll answer your question in reverse order. Yes, the 800-megahertz handset would be able to seamlessly access the network, as long as there's 800-megahertz sites on air there. To your second question, we start with a 5x5 [ph] FBD (43:19) channel for 1.9-gigahertz LTE. Once Sprint Spark is launched, the phones will have access to significantly more spectrum, including 20-megahertz TDD at 2.5 GHz. And where we have 800-megahertz LTE, [ph] you will be another (43:35) 5 megahertz as well. So with Sprint Spark, significantly more spectrum will be made available.

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

John C. Hodulik
UBS Securities LLC

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Okay, thanks. Good morning, guys. I know there's a lot of talk about pricing, but seems like churn is really sort of the main issue. And I guess a couple questions or clarifications. I guess are you guys calling for churn to increase sequentially in the third quarter? We had it sort of a falling a little bit in the third quarter, again in the fourth quarter. And then if you go to slide 9, it looks like the benefit you're getting from the rebuild is lower versus the national average than it was that you showed last quarter, fairly meaningfully. I just want to make sure that delta quarter to quarter is just a function of the national average churn coming down versus any sort of difference in the efficacy of the build that you're seeing. Thanks.

Daniel R. Hesse
Chief Executive Officer

A

Yeah, hi, John. Yes, you're correct that we are not seeing less benefit from the build, that the averages are coming down. So we are continuing to see the same improvements and the same trend in improvements as we continue to get further and further past, if you will, 70% complete with Network Vision. So, exactly. The averages are coming down as we get further along each quarter. And we would expect that to continue.

You're correct that we are seeing improvements in voluntary churn because of the improvements in our network, but it is not enough by itself to offset all of the seasonality. What we indicated is that it's offsetting, if you will, about half of the normal seasonality we've seen traditionally between second quarter and third quarter. So, getting back to your earlier question, over time – it's gradual – as we move forward with the Network Vision build, we're seeing voluntary churn continue to improve gradually, but in one quarter it's not enough to offset what's really a fairly significant normal seasonal spike in the third quarter all by itself.

The other thing I'll mention on churn is again we haven't made any decisions yet. But one would also expect, if we were to make decisions with respect to repricing and as your price levels get more competitive, there would be churn benefits at that time as well. And, as indicated earlier, there have been a number of competitive pricing moves in the market since we launched Framily back in January. So in addition to network helping post-paid churn, depending upon what we may decide to do in terms of pricing, that could also yield churn benefits going forward.

Operator: Your next question is from the line of Phil Cusick with JPMorgan. Mr. Cusick, your line is open.

Brad Hampton
Vice President-Investor Relations

A

Might be muted. Phil, if you're on mute, we can't hear you. Okay, Kristy, let's move on to the next question, please.

Operator: Your next question is going to be from the line of Jonathan Chaplin with New Street.

Jonathan Chaplin
New Street Research LLP (US)

Q

Thanks. Two quick questions, if I may, firstly for Dan. Given that the market [ph] has sort of been upgraded by 70% for more than six and 10 months (47:37) have been increasing steadily over the course of the last three

quarters, why aren't we seeing it show up in average churn? Why isn't average churn for the company coming down at this point? And then quickly for Dr. Saw, I think it was mentioned that 3x carrier aggregation will be available at the end of 2015. Can you remind us of when 2x carrier aggregation is going to be ready and whether handsets that you're putting into the base today are capable of using 2x and 3x carrier aggregation? Thank you.

Daniel R. Hesse

Chief Executive Officer

A

Yeah. Hey, Jonathan. I want to make sure that I understand the question. First, we have seen an improvement sequentially in voluntary post-paid churn. But what you do have is you do have two things going on, and that is in those markets that are not 70% complete yet, and there are some of those, churn in those markets is actually increasing. And then in markets that are, over time, past 70% complete, you begin to see, if you will, a stabilization when you get to 70%. And, after a certain number of months, you begin to see that improve. So with respect to voluntary post-paid churn, as per the previous question, that is actually coming down.

And we expected, as we mentioned in my comments, as opposed to a typical increase in voluntary churn seasonally between Q2 and Q3, we believe it will decrease in Q2 to Q3 and possibly be the best sequential performance in post-paid churn that we've ever seen between a Q2 and a Q3, so we're still seeing those churn benefits.

John Saw

Chief Network Officer

A

Hey, Jonathan, John here. With regards to your question on carrier aggregation, you're correct. 3x carrier aggregation is available end of 2015. 2x carrier aggregation will be available end of this year. And in order to benefit from the full capabilities of carrier aggregation, we will need new handsets, and that is why Dan said that we're working closely with our vendors to make sure that we have enough handsets and we pre-seed the markets with this carrier aggregation-capable handsets.

Brad Hampton

Vice President-Investor Relations

A

Okay, next question.

Operator: Your next question is from Michael Rollins with Citi Investment.

Michael I. Rollins

Citigroup Global Markets Inc. (Broker)

Q

Hi, thanks for taking the questions. Dan, I was curious if you could take a step back on maybe the last year, year and a half, and if you could talk a little bit about the impact innovation has had on gross adds and incremental revenue, whether it's launching the HTC phone that you did, or some of the other initiatives that you had to either build revenue or build customers. And maybe contrast that with the effectiveness of using price to get more share, and – just so we can get a sense of how innovation over time can help your results versus just having to block and tackle on value and price. Thanks.

Daniel R. Hesse

Chief Executive Officer

A

Yeah, thanks. I mean, obviously the best situation or best scenario would be, if you really have both a strong network and you innovate on top of it. And what we believe is that the innovation has kept both our brand strong and has mitigated some of the impact you talk about over the last year and a half of some of the network issues

that we've encountered. And innovation on a variety of platforms. I think Spark, and particularly for customers once they get a Spark device and get Spark coverage, that has made a significant difference.

With respect to the other like lifestyle – in music, for example – we believe that has helped us. It's helped not only our brand but if we were just to compare, for example, the Harman/Kardon edition of the HTC One M8 versus the Standard edition, even though we charge a noticeable premium for the Harman/Kardon edition, it outsells the Standard edition, which is available to everyone, significantly. What we're doing in the area of fitness that just launched on the 25th of July, so it's too early to predict. So what we're hoping is that if you combine, if you will, a strong network with competitive pricing and then think of innovation as the icing on the cake, the differentiator, it will give us additional lift. But we do believe that it has certainly helped us during this period of network overhaul and network dust and continues to make our brand relevant.

And as I mentioned earlier, on the patent side, we continue to generate intellectual property at a rapid rate and generating an average of over two U.S. patents being granted to us over the last couple of years, and that gives us even more potential to continue this innovation. So it gives us, if you will, some optimism about the future once we get this strong platform in place, because what Spark will enable you to do, as the core platform of all of the innovation platforms, is if you have the kinds of data speeds that I've described with 2x and 3x carrier aggregation, it just opens up a lot of avenues for innovation when you have that kind of special network capability that we haven't had heretofore.

Thanks, Mike.

Brad Hampton
Vice President-Investor Relations

A

Kristy, we have time for one final question, please.

Operator: That'll be from Tim Horan with Oppenheimer.

Timothy K. Horan
Oppenheimer & Co., Inc. (Broker)

Q

Thanks, guys. Joe, could you give us a little bit more color on the EBITDA and CapEx trends? Your guidance is for the margins to decline here a bit in the second half. And I'm just wondering if there's much low-hanging fruit on the expense side to reduce expenses over the next 12 months to see the EBITDA ramp into next year. And then on the CapEx, great job on keeping that under control. Maybe a little bit more color on what you're doing to reduce that. And is this a good run rate for next year, or do you think you can kind of continue to reduce CapEx at this point? Thanks.

Joseph J. Euteneuer
Chief Financial Officer

A

Yeah, so let me answer your questions in reverse order. In regards to CapEx, I mean, I think the combination with SoftBank has allowed us to go out and negotiate a lot cheaper rates, along with John's work with their team in figuring out how to be more efficient, et cetera. So we're just seeing the benefits of those now. We haven't come up with guidance yet for next year. But we've not come off our plan of wanting to continue to improve the capital expenditure line. In regards to expense takeout, I got to commend our team here. We've hit quarter after quarter, we continue to find ways to take expenses out of this business and continue to improve our efficiency across the board in every area. And we have visibility now, 12 months out, of continued things that we're going to do over the

next 12 months. So I feel very, very positive of about our ability to continue to take expenses out and improve our margins while we work on turning the subscriber growth around.

Brad Hampton

Vice President-Investor Relations

Thank you, everyone, for participating in our call today. As Dan mentioned, we would encourage you to visit our IR website and view the Virgin Mobile video about the exciting announcement we made today, the new rate plan from Virgin Mobile. If you have additional questions about today's results, please contact our Investor Relations team. Thank you.

Operator: Ladies and gentlemen, this does conclude today's teleconference. You may disconnect at this time.

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