

04-Aug-2015

Sprint Corp. (S)

Q1 2015 Earnings Call

CORPORATE PARTICIPANTS

Jud Henry

Head-Investor Relations

R. Marcelo Claure

President, Chief Executive Officer & Director

Joseph J. Euteneuer

Chief Financial Officer

Masayoshi Son

Chairman

OTHER PARTICIPANTS

Michael I. Rollins

Citigroup Global Markets, Inc. (Broker)

Kevin Smithen

Macquarie Capital (USA), Inc.

Philip A. Cusick

JPMorgan Securities LLC

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Brett Joseph Feldman

Goldman Sachs & Co.

Amir Rozwadowski

Barclays Capital, Inc.

Jonathan Chaplin

New Street Research LLP (US)

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and thank you for standing by. Welcome to the Sprint Fiscal First Quarter 2015 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, Head of Investor Relations. Please go ahead, sir.

Jud Henry

Head-Investor Relations

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, Joe Euteneuer; and our Chairman, Masayoshi Son.

Before we get underway, let me remind you that our released quarterly investor update and presentation slides that accompany this call are all available on the Sprint Investor Relations website at www.sprint.com/investors.

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

Turning to slide 3, throughout our call we will refer to several non-GAAP metrics. Reconciliations of our non-GAAP measures to the appropriate GAAP measures for the quarter can be found on our Investor Relations

website. In addition, I would like to mention that all references to customers or connections in our remarks represent the results or expectations for the Sprint platform unless otherwise indicated.

Let's move on to earnings for our first fiscal quarter of 2015 on slide 4. Net loss in the quarter was \$20 million, or a loss of \$0.01 per share compared to net income of \$23 million or earnings per share of \$0.01 in the year-ago period, primarily due to higher interest expenses.

Lastly, although Clearwire's financial results are now consolidated with Sprint and included in today's presentation, its standalone quarterly financial results will be made available on our website in the next several weeks as required by its debt covenants.

I will now turn the call over to Sprint's CEO, Marcelo Claure.

R. Marcelo Claure

President, Chief Executive Officer & Director

Thank you, Jud, and good morning, everyone. It has almost been a year since I started as CEO, and we have made great progress in our transformation with improvement across the key operating metrics of the business and it's exciting to see the company competing again as a result of our turnaround plan. I'm confident that we're on a path to return Sprint to growth, profitability and ultimately free cash flow positive.

Our network performance has substantially improved in every aspect. In every major market, we are confident in the future potential of our network through next-generation network plan. Our operating expenses improved versus a year ago. We had our best-ever postpaid churn in the company's history improving 49 basis points year-over-year.

Postpaid phone net additions were up over 600,000, improving from negative a year ago to positive for the last two months of the quarter, with a significant increase in prime customer additions.

We continue to leverage new sources of capital outside the public market to fund our turnaround including working with SoftBank and other partners in filling up a leasing company that will finance these customer device leases on attractive terms. And with the leadership changes we have made over the last year, we now have the team we believe will make Sprint successful going forward.

Turning to slide 6, we're returning to growth as a result of our improved brand positioning, compelling value propositions, and a greatly improved network. As you can see reflected in our first quarter results, we had the biggest year-over-year improvement in the industry for postpaid net addition and churn. We added 675,000 total net additions in the quarter which marks nearly a 900,000 improvement from the net loss of 200,000 connections a year ago. And over the last four quarters, we have added a total of 3.5 million connections.

Postpaid net additions improved by nearly 500,000 with 310,000 net additions compared to net losses of 181,000 a year ago. Our postpaid gross additions were the highest for June quarter in eight years and we had the highest prime mix for a June quarter in over six years. While we're pleased with improving sales trends for postpaid, we're especially focused on reducing our churn, which was the best in company's history this quarter at 1.56%, improving by 49 basis points year-over-year and beating our previous record low by 13 basis points. This underscores the tremendous improvement in our network and overall customer experience as more and more of our customers choose to stay with us and as a result of improved quality of customers we're attracting. This will continue to be a key focus for the company as the cost of retaining existing customers is significantly less than the cost of acquiring new customers.

This higher level of customer engagement can be seen in our postpaid upgrade rate for the first quarter of 7.9%, which is up from 7.2% a year ago. As a matter of fact, we saw a 25% reduction in port-outs year-over-year despite plenty of promotions from our competitors and we were postpaid network positive for the second consecutive quarter.

Most importantly, we returned to growth in postpaid phone net additions in each of the last two months of the quarter and almost for the full quarter net losses of 12,000 improved for the fifth consecutive quarter and by over 600,000 compared to the 620,000 postpaid phone losses we experienced a year ago. I am happy to report that this positive trend continues for a third consecutive month in July and we expect to be postpaid phone positive for the full quarter in the second quarter.

Our postpaid phone gross additions were up 13% year-over-year and our prime postpaid phone gross additions were up 47% from a year ago, continuing our focus on quality as much as quantity of growth. As we previewed in our last call, we experienced prepaid net losses in the quarter of 366,000 but actually improved by 176,000 year-over-year due to fewer losses under the Assurance brand. Our wholesale business continues to grow for the eighth consecutive quarter, with net addition of 731,000, a 45% improvement year-over-year.

Now, let me update you on the progress of each area of our turnaround plan. Turning to slide 7, our network continues to get better every day, and we have continued to make progress in our goal of providing a network that delivers a consistent reliability, capacity and the speed that our customers demand. Independent mobile analytics firm, RootMetrics, recently completed testing of the top 125 markets for the first half of 2015 and Sprint was awarded a total of 180 first place RootScore Awards compared to only 27 awards in the first half of 2014.

We continue to considerably close the gap to Verizon in overall network performance, in a few of the major metros we're now tied for the best overall network. In addition, we're pleased to see OpenSignal's report that Sprint had the lowest 4G LTE latency in the June quarter of 2015, beating out AT&T, Verizon and T-Mobile and moving up from a last-place finish in OpenSignal's report one year ago.

Latency is important because it measures the delay between the time wireless information is sent and received, meaning faster transmission, which is important in today's highly interactive world. Besides the continuous focus on optimization, we have also expanded the breadth and depth of our LTE network with the continued expansion of the 800 megahertz and the 2.5 gigahertz LTE overlays to greatly improve the overall network performance. We have seen immediate improvements in the consistency and reliability of LTE performance and while we're still expanding the 800 megahertz at 2.5 gigahertz footprint, we have already seen our average download speed across the network increase 133% year-over-year as a result of incremental capacity as we add the second layer and third layer to our LTE network.

Furthermore, in an effort to make our network faster every day, we have begun the deployment of carrier aggregation to create wider channels and produce more capacity and faster speeds. Carrier aggregation is important because it allows us to unlock the potential of our deep 2.5 spectrum position and build the big pipes that our customers need. The network team has been rolling out two channels or 2x20 megahertz carrier aggregation in the 2.5 gigahertz band in 80 markets across the country including major markets like Chicago, Atlanta, Houston, San Francisco, and Detroit and we'll continue adding more sites and more markets over time.

For those locations with carrier aggregation, we expect sector capacity and the speeds to double, which means customers with capable devices are already experiencing significantly faster speeds. Early results are showing peak speeds of 125 megabits to 135 megabits per second in markets like Chicago and San Francisco, making Sprint very competitive on speed today. And Sprint is one of the first operators worldwide to roll out carrier aggregation

with antenna beamforming. With beamforming, we can significantly improve our users experience at the cell edge and tests by independent third parties have confirmed the performance gains that we see.

We already have seven 2x20 carrier aggregation enabled devices available to our customers including the Samsung Galaxy S6 and we plan to grow the portfolio of devices so more of our customers can enjoy the great experience.

Now, let me update you on our network densification plans on slide 8. As I know, many of you are anxious to hear more about based on the amount of speculation I keep reading in the press. Our network is already good today, as I mentioned, and now we're ready to take our network to another level. With the support of our board and our Chairman Masa, we are prepared to embark on the next phase in the evolution of our network to unlock the true potential of our spectrum portfolio by combining the strong Network Vision foundation of the Sprint network with the rich spectrum assets that we acquired with Clearwire.

As we discussed last quarter, this plan includes significantly densifying our network by increasing the number of sites across all spectrum bands to expand our multilayer network strategy. This will include thousands of new macro sites to expand coverage and optimize our core network foundation leveraging our existing vendors. In addition, we're expanding the 800 megahertz and 2.5 gigahertz deployment to the majority of our existing sites making nearly all of our existing sites thrive on LTE.

Furthermore, we plan to deploy tens of thousands of small cells in the next three years to increase the coverage and capacity of the network, leveraging all spectrum bands with the potential to increase the number over time. We plan to be extremely surgical and efficient by leveraging big data and network diagnostics to determine the optimal design at a street corner level. In the past, our engineers would design based on theoretical propagation models, but today, there are so many more tools available to enable precision execution.

The best part is that this will be a progressive build whereby the customer experience will only improve as each incremental site comes on air with no expected disruptions to their service from existing sites. This unique plan will leverage some existing vendors as well as embracing innovative new company that brings unique products and services to the table. In addition to new vendors and developing technology advancements to maximize capital efficiency, we also fully embrace the participation of our parent company, SoftBank, since they operate a world-class network in Japan and have a wealth of knowledge and experience with small cell deployment and 2.5 gigahertz deployment in particular.

It has been so exciting to see Masa personally involved to challenge everyone to think outside the traditional telecom model, and we have experienced a highly collaborative process comprised of Sprint and SoftBank engineers to fully harness the creativity, assets, and experience of both companies with one common goal: to help Sprint develop a differentiated network.

Also, we expect to utilize various options for deployment of backhaul for small cell in order for us to balance the performance, cost, and speed to market. The team is extremely excited about not only the performance enhancement this plan is expected to deliver, but also the significant expected financial efficiency from both a capital and operating perspective compared to a traditional build model, requiring significantly less CapEx to achieve the desired performance and capacity, as well as lower anticipated operating cost to support. We're confident that this plan will deliver the capacity, speed, and coverage to position Sprint for network parity or superiority over the next two years, and with addition of our unique depth of spectrum, we will be best positioned of all the carriers for the growing data demands of the future.

Regarding our cost structure on slide 9, we continue to drive to significantly reduce our cost of operating the business through a simplification and transformation of every business function. We're exceeding our original target for reductions, which will fund the many turnaround initiatives we're implementing to attract and retain customers and improve the customer experience. In addition, we're already beginning initiatives to eliminate as much or more cost next year as we continue to reinvent how we operate and focus our spending on acquiring, retaining, and serving our customers. This includes a team dedicated to improve procurement and operational efficiency using zero-based budgeting, reducing our roaming expenses and the cost of running our network and optimizing our spend in sales, marketing, care and IT.

Moving to slide 10, while we're making great progress in growing our customer base, we will continue to enhance our value proposition through targeted actions to improve our acquisition and retention of customers as well as our brand. At the end of the quarter, we launched All-In Wireless and we raised the price of Unlimited Horizons in the process by eliminating the \$50 unlimited plan. We also continue to optimize our distribution model to make sure we have enough doors in the right locations to attract and serve customers. Our 1,435 co-branded Sprint and RadioShack stores are currently open and staffed with Sprint employees and we expect to update the signage and fixtures of these stores by the end of calendar year 2015.

We also continue to expand a revolutionary wireless shopping experience, Sprint Direct 2 You. We're also focused on further reducing our churn by continuing to transform the customer experience. Besides continued focus on network improvement, we will engage our high-value customers to make sure that they are fully satisfied.

Turning to slide 11, perhaps most importantly we have a funding plan to support this turnaround by leveraging our business relationship and assets to allow us to continue to invest efficiently in growing the business. As far as additional sources of funding, Sprint has been working with SoftBank and other partners in setting up a leasing company that will finance these customer device leases on attractive terms. These arrangements are expected to be finalized in the coming months and SoftBank is expected to be a minority equity investor in the leasing company. As you probably know, one of our biggest uses of cash is the sales of devices to customers, particularly under leasing where we only receive the monthly payments over the lease term until recovering the residual value at the end. Through this facility, Sprint is expected to receive proceeds equal to the net present value of not only lease payments but also the residual value.

As we begin our network densification program, we're also working with SoftBank and other partners to potentially establish another leasing company that will help finance the network deployment. With these potential additional sources of capital, the reduction in our operating expenses, and the capital-efficient densification of the network, our goal would be to not raise additional capital through the public debt or equity markets or sell spectrum in the foreseeable future.

Last but certainly not least, we continue to establish and engage our winning team by attracting and retaining world-class talent as seen on slide 12. We continue to strengthen the team with the addition of our new Chief Marketing Officer, Kevin Crull, on May 31. Kevin joined us from Bell Media in Canada where he served as Chief Operating Officer and then President. He has already raised the bar for the team in a short amount of time with a fresh perspective and a wealth of new ideas.

Yesterday, we announced that Tarek Robbiati will join Sprint at the end of August as our new Chief Financial Officer. After having spent 25 years successfully leading telecommunication companies through complex business transformations, Tarek most recently served as CEO of FlexiGroup, an Australian consumer finance company specialized in leasing. He has deep telecommunication experience with other positions at Telstra, CSL and Orange.

After assisting with a smooth transition over the next few months, Joe Euteneuer will be leaving Sprint. I will always be thankful for the way Joe helped me as I took on the role of CEO. He's an experienced and talented financial executive and he has been a solid partner as we have run the business over the past year. We also announced yesterday that Günther Ottendorfer will be joining Sprint as Chief Operating Officer, Technology. Günther is a world-class innovator and he comes to us with a rich experience of pioneering the use of the latest technology and leading wireless network transformation at telecommunication companies in Europe and Asia including Telekom Austria Group, Optus Singtel and Deutsche Telekom. John Saw will be promoted to Chief Technology Officer and will report to Günther. We've all seen the incredible progress that Sprint has been making with the network improvement under John's leadership and John will now be responsible for technology development, planning, engineering, deployment and service assurance of the Sprint network.

After one year, I'm confident that we have built the right team with an organizational structure and culture to make Sprint successful.

I will now turn the call over to Joe to take you through our financial results for the first quarter.

Joseph J. Euteneuer

Chief Financial Officer

Thank you, Marcelo. I'll now walk you through our financial results for the fiscal first quarter. Moving to revenue on slide 13, consolidated net operating revenue of \$8 billion for the quarter was down \$762 million year-over-year, driven by lower wireless and wireline service revenues as well as lower equipment revenues. Service revenues of \$7 billion for the quarter were down 8% year-over-year due to lower postpaid phone customer base and a higher mix of customers now on rate plans offered in conjunction with device financing programs as well as lower wireline revenues.

Looking at wireless service revenue on a more comparable basis, service revenues plus installment billings and lease revenues declined only 3% year-over-year, with that decline driven by postpaid phone losses and a higher tablet mix in the base.

Equipment revenue of \$990 million for the quarter declined \$116 million year-over-year mostly related to lower installment billing sales volumes which recognize more revenue at the point of sale, partially offset by growing revenue from leased devices which is recognized over time. For example, instead of recognizing \$600 upfront for an iPhone under an equipment installment sale, we only recognized the monthly lease payment of \$20 each month on a lease transaction.

Finance postpaid devices grew to 64% this quarter with roughly 51% selecting our leasing plan. This compares with device financing take rates of 53% last quarter and 28% a year ago. While we did see a step-up in the financing mix earlier in the quarter, we have begun to see the mix stabilize as it was nearly identical across the three purchase methods in each month of the quarter as well as in July, and expected to be roughly the same this quarter.

Sprint platform postpaid average total billings per account, if you add monthly equipment installment billing and lease revenue to service revenue per account, was \$164.63 for the quarter and increased 2% year-over-year as higher installment billings and lease revenues more than offset the lower monthly service charges offered in conjunction with device financing options as well as the fact that our average lines per account has increased more than 5% year-over-year.

Looking at postpaid phones specifically, postpaid phone ARPU of \$69.91 for the quarter increased 1% sequentially, maintaining pricing discipline for future profitability and growing the monthly cash flow stream from our customers. Prepaid ARPU of \$27.81 for the quarter increased \$0.43 year-over-year, primarily driven by changes in the mix of our customer base among our prepaid brands, partially offset by pricing changes in our Boost brand.

Turning to slide 14, our adjusted EBITDA was \$2.1 billion for the quarter, which increased 14% year-over-year as expense reductions more than offset the decline in operating revenues. Total operating expenses improved from a year ago in spite of a 16% year-over-year increase in retail sales volumes. While the reduction in cost of product expenses was primarily due to the introduction of device leasing options for which no cost is recorded at the point of sale, we also saw lower average cost per prepaid device sold due to brand and device mix.

In addition, we had lower cost of service expenses and lower wireless bad debt expense as a result of a higher mix of prime credit quality customers. Operating income of \$501 million in the quarter was essentially flat year-over-year as higher depreciation expense associated with the introduction of device leasing offset the items that I just discussed related to adjusted EBITDA.

Turning to CapEx and cash flows on slide 15. Cash capital expenditures were \$2.3 billion in the quarter, compared to \$1.2 billion in the year-ago quarter. The \$1.1 billion increase in spending was due primarily to \$556 million greater investments in the network as well as \$544 million related to device leasing in our indirect channels where we purchased the leased devices from the dealers and the retailers. Free cash flow was negative \$2.2 billion for the quarter compared to negative \$496 million in the year-ago quarter. The year-over-year change was primarily impacted by the unfavorable changes to working capital and higher capital expenditures as the shift to installment billing and leasing for devices from the subsidy model shifts customer payments for devices from the point of sale to receiving them over time.

Normalizing for non-operational impacts of a \$500 million repayment in the quarter on the service receivables facility, free cash flow would have been negative \$1.7 billion for the quarter, which is roughly flat to last quarter when adjusting for the \$500 million receivables draw and a small spectrum sale.

As a result, we ended the quarter with total general purpose liquidity of \$6.6 billion, comprised of cash, cash equivalents and short-term investments of \$2.3 billion, \$2.9 billion of undrawn borrowing capacity under our revolving bank credit facility, and \$1.4 billion of undrawn capacity under our service and EIP receivables financing agreement at the end of the quarter. In addition, we had \$1.3 billion in undrawn availability under our network vendor financing to be utilized towards the purchase of 2.5 gigahertz network equipment.

Looking at guidance for fiscal year 2015 on slide 16. As a result of improved subscriber trends, a greater reduction in operating expenses, and a higher mix of sales on device financing, we are raising our expected consolidated adjusted EBITDA guidance for fiscal 2015 from \$6.5 billion to \$6.9 billion to an expected range of \$7.2 billion to \$7.6 billion, excluding any accounting impacts of the potential lease financing as a result of whether it is on or off balance sheet. This represents roughly a 12% increase over prior guidance and a 25% year-over-year improvement at the midpoint of the range.

Furthermore, we expect operating income for fiscal year 2015 to be between \$200 million and \$500 million. This represents an expected increase from the \$238 million of operating income in fiscal 2014 when excluding the noncash impairment charge. We believe this is an important metric to look at as well when evaluating the company, as it takes into consideration the depreciation expense associated with device leasing. In addition, we remain focused on maximizing our capital efficiency while continuing to improve the performance of the network, as Marcelo discussed.

We currently expect cash capital expenditures to be approximately \$5 billion for fiscal 2015, excluding the CapEx associated with purchasing leased devices in indirect channels. Regarding the longer-term outlook, we expect that 2015 will be the peak cash flow burn and have a plan to substantially improve the company's cash position. We understand the importance to get to free cash flow positive as soon as possible and we are working diligently towards that goal.

We expect continued progressive improvement in postpaid churn and phone net additions that will get the top line working for us again with service revenue stable from 2015 to 2016 and operating revenues growing next year.

As Marcelo discussed a moment ago, we are aggressively focused on reducing the operating expenses of the business and while much of the reductions this year are being reinvested into strategic platforms for long-term growth, we expect further aggressive expense reductions in 2016 and beyond that are equal to or greater than what we are taking out in 2015. Likewise, we are very focused on capital efficiency and concentrating our resources on evolving our network to be highly competitive. As a result, we expect to deliver a great network while our CapEx over the next three years including 2015 is expected to be less than \$15 billion.

At the same time, we are always looking at ways to reduce our operating expenses, and in some cases, may require additional CapEx or investment in the short-term to gain long-term benefit to the operating margin. Over the next term, we expect to leverage the capacity under our receivables facility and the vendor financing on the 2.5 gigahertz build as well as the potential leasing facilities that Marcelo mentioned. Altogether, we continue to diversify our portfolio with shorter 10-year facilities with the goal to not raise additional capital through the public debt or equity markets or sell spectrum in the foreseeable future.

I'll now turn the call back over to Jud.

Jud Henry

Head-Investor Relations

Thanks, Joe. In just a moment, we will begin the Q&A. I would first like to turn the call over to our Chairman, Masayoshi Son, to share his thoughts.

Masayoshi Son

Chairman

Hi, this is Masayoshi Son. I'm extremely excited about the turnaround of Sprint. So as you might have imagined, when I entered into the U.S. market, I had a plan to have a consolidation in the industry but that's no longer the case. So I lost the confidence for some time. However, the last few months I am totally refocused to help Marcelo and the team have the historical turnaround of the company, and I've been working – very, very involved especially on the networks side. I have been involved with my engineers almost every night from 10:00 p.m. up to 2:00 a.m., almost every night and designing the next-generation network and looking at the opportunities to improve the OpEx.

So as a result, Marcelo and I and the total team of Sprint and SoftBank together and now we have a plan to have a big turnaround. I am extremely excited about that and I have a confidence for that especially with a new leader, Marcelo, which I have full confidence. So I am excited. I don't want to sell the company. I believe Sprint is going to be one of the very, very good companies of which I will be very proud. So I'd like to answer any questions together with Marcelo.

Jud Henry

Head-Investor Relations

Thank you very much. Suret, please inform our participants on how to queue up for the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from Michael Rollins with Citi.

Michael I. Rollins

Citigroup Global Markets, Inc. (Broker)

Q

Hi. Thanks for taking the questions. If I could have two questions. One, if you could talk a bit more about the cost of leasing, whether it's for the devices that you want to lease or the capital equipment that you want to lease, how should investors think about the cost of doing that?

And then secondly, can you talk a bit more about strategically what you're looking to accomplish? If you spend less than \$15 billion over three years in capital, what do you get for that in terms of network capability, in terms of cell density, and in terms of the timing of being able to market a better mobile broadband service than you have today? Thank you.

Joseph J. Euteneuer

Chief Financial Officer

A

Sure. I'll take the first question. This is Joe. In regards to the cost of leasing, think about it, it's a little bit similar to the securitization we've done. There's an interest rate associated with the money, and that's really it. It's just a financing vehicle. It's short-term in duration. If you think about the handsets, handsets we're looking at a 24-month duration on leasing of the network that will go maybe a little bit longer depending on the equipment.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

This is Marcelo. Let me talk a little about the network and try to address some of your questions. First, let me start that we're able to build on a Network Vision foundation which is basically a great foundation that from now on is going to be enhanced. Now, how are we going to enhance our network? First is, as we've said, we plan to add thousands of incremental new tri-band micro sites, so that obviously is going to expand our coverage. Secondly, we have a lot of our sites that we've explained that were either 1.9 only or 801.9 and we're going to upgrade nearly all of our existing sites to be tri-band and that should definitely help with coverage and capacity.

And furthermore, leveraging on the experience of SoftBank in Japan, we plan to deploy tens of thousands of small cells and that obviously is going to further improve coverage and capacity. So we believe that with that and what we've shown is that our network is going to be able to have parity or superiority in the next two years. The initial densification that we've done in some places, in some markets in the U.S. have already proven that if we densify our network and we leverage our spectrum, we have the capacity to be number one. And if you look at several of the RootMetrics tests, we are number one in many different – in the entire overall network experience in many different markets, something that we didn't have in the past.

Traditionally, one area that we were lagging behind was speed. And now as we've rolled out carrier aggregation in up to 80 different markets, we have seen speeds to be between 125 megabits to 135 megabits per second in many cases. So we feel very good about the network. We feel very good about our plan, and I don't know, Masa, if you want to add something as it relates to the network.

Masayoshi Son

Chairman

A

Okay, this is Masa. As you may know, Japan has the best network in the world. To me, every time I come to the States, I say this network in this country is not something that you should be proud of. It is actually very bad. It's not just Sprint, even Verizon, AT&T and T-Mo, all network is pretty bad. I'm going to say U.S. invented Internet, U.S. invented telephony but network is not something that you should be proud of.

So I would say the network that we created in Japan is much, much more superior. That's a fact: coverage, the speed and all the integration. However, within Japan, SoftBank spent almost half in CapEx compared to our competitor, but the result of our network coverage, the speed is number one. So what we're good at is spending less in CapEx and create a number one network. Of course, it's easy to spend money and get the result, but if you have less money and then still want to achieve the number one network, you have to use brain instead of money and muscle.

So we have used brain a lot, and came up with all kinds of unique solutions that other companies do not have. We created by ourselves. So we discussed with Sprint engineers and SoftBank engineers and initially the reaction was the U.S. environment is different. However, after all these studies, most of the key fundamentals are exactly identical.

So SoftBank has 2.5 gigahertz spectrum, Sprint has 2.5 gigahertz spectrum. Both of us are using TD-LTE on top of FDD-LT. So the common practice, common know-how, common technologies could actually apply. So I am now very, very confident that Sprint will be able to create equal or better. In my view, it will be a lot better network very soon with much lower CapEx.

Michael I. Rollins

Citigroup Global Markets, Inc. (Broker)

Q

Thank you.

Jud Henry

Head-Investor Relations

A

Next question, please, Jared?

Operator: Okay. And your next question comes from Kevin Smithen with Macquarie.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

Yes. A question for [ph] Son-San (38:48) and then Marcelo and Joe. Son-San, what is SoftBank's involvement likely to be in the new leasing company? How much equity are you likely to put in? Who are the other partners that you're bringing to the table and what are the issues before this is finalized? And how quickly can this entity provide financing into Sprint? And then finally, I think Marcelo mentioned that you're considering a finance company for the network separately? Maybe you and Marcelo can talk a little bit about that and how you can provide liquidity into the company to fund the network expansion?

Masayoshi Son

Chairman

A

Yeah. Okay, so basically all of the money that's required for handset – so I am the inventor of installment-based payment for the handset. So we experienced this handset installment-based payment already almost eight years ago. So we sell handset not upfront; we sell in 24 months, but we have to pay to the vendors in net 30 days and so on. So the capital requirements become huge and it piles up to several billion dollars. So cash flow became an issue. Then we came up with a solution of securitization of the handset accounts receivables.

So Sprint is now doing similar things by selling handsets in lease with Marcelo's leadership and also some Internet-based payments. So same kind of cash requirement comes. So as a solution for that, we are preparing handset lease facility to accommodate the handset lease sales. So size of the capital is as much as it's needed basically for the handset lease. So effectively it will be neutral. Handset cash requirements would be offset by total amount of the handset lease financing and SoftBank will be bringing equity partner. SoftBank will be the minority partner, and this will be a very good market rate funding and we will provide together with our partner as much as Sprint needs for the handset.

Similarly, we are preparing network equipment lease facility. Again, CapEx is a long-term investment. So we are going to provide solution together with our equity partner for the network equipment and also the small cell foundations. So that's something we are still in preparation, but making a very good progress.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

And this partner has been identified and is conducting due diligence? Any issues to get this closed on either the leasing company or the network financing company?

Masayoshi Son

Chairman

A

I see absolutely no issues. It's progressing very well. I'm confident it will be done very soon.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

Okay, great. And then last question, Joe, if we look at the free cash flow this quarter, obviously accounts receivables spiking. Will that get trued up when this leasing company is finalized? So will the receivables effectively be sold?

Joseph J. Euteneuer

Chief Financial Officer

A

Well, so, Kevin, just remember the reason for the spike up in the receivables is the sale of the receivables in the previous quarter that then we paid off that securitization and then allowed the receivables to build back up. So what you're going to have happen now on the lease co-facilities on handsets, that'll be a little different, right, because we're going to sell tranches of handsets and then pay that back over time. So it'll be a little different and we'll get you into the accounting once we have the specifics about whether it's on or off balance sheet, et cetera, but clearly, a good vehicle to fund the growth of the business.

R. Marcelo Claude

President, Chief Executive Officer & Director

A

Kevin, it's Marcelo. Let me add one thing that I think is important. It's the way we're setting up this facility is very different, because on traditional installment billing, all you had to do was basically sell receivables. And for this we had to leverage our partner, SoftBank, Brightstar, in order for us to be able to sell these receivables but receive profits that are equal to a net present value of not only the lease, but very important also the residual value of the handset. And I think that is quite important because, as you know, most of the high-end devices that we have carry a very high-end residual value and being able to monetize that at the beginning as we sell the phones is going to create a very important effect, which means our cash is going to be neutral as we sell handsets. One of our biggest uses of cash has been basically leasing devices. So we believe that we have found a very good solution.

And as we said in my remarks is based on this, our intent is not to issue any additional public debt or equity or sell a spectrum in the near future. So we believe that with these new financing arrangements that we're finalizing that this is going to be very positive as it relates to fund the growth of Sprint.

Kevin Smithen
Macquarie Capital (USA), Inc.

Thanks a lot.

Jud Henry
Head-Investor Relations

Let's have the next question.

Operator: Okay. Your next question comes from Phil Cusick with JPMorgan.

Philip A. Cusick
JPMorgan Securities LLC

Hey, guys. Thanks. I guess just to follow up a little bit on this. You said your goal is not to sell public equity or debt, but all these leasing vehicles and vendor financing, there's real interest expense and there's real debt that has to be borne by investors. Do you expect any need for private market equity or debt placements? Or is it at all this is sort of off balance sheet stuff? And when do you think that the net debt balance, including all the off balance sheet stuff, really peaks and the company starts generating cash?

And then second, if I can, for Masa, if you don't want to sell the company and Sprint so clearly needs more capital, why not just buy in the stub? Thank you.

R. Marcelo Claure
President, Chief Executive Officer & Director

Masa, why don't you start with the second one and then...

Masayoshi Son
Chairman

Okay. So it's a public company, so I shouldn't answer some of your questions. It's a nice try, but in my experience that we are a public company. I would not make any comment of such a question. But anyway, I am much more confident about Sprint, and Marcelo is running a great turnaround and I would support as much is needed. And I am very confident. As you say, this is sort of a financing, however, because handset sales of lease was creating a lot of need for the cash. This is basically neutralizing the incremental cash needs, because we have to pay to the vendors net 30 days and whatever short term. But revenue comes in 24 months. So this is effectively neutralizing. And I think the handset, the lease, most likely will be off balance sheet because Sprint is not effectively taking risk

on that. So this will be a great improvement. And Marcelo is preparing a big cost efficiency in OpEx and CapEx, so very soon the company would have reduction in total net debt.

R. Marcelo Claure

President, Chief Executive Officer & Director

A

Let me elaborate a little and just to be clear we have a plan as it relates to – obviously continue to reduce expenses that will generate additional cash and in addition through the different leasing vehicles that we have, we're clear as it relates to not raising additional public debt or equity in the near future or raising private debt. I mean, we believe that through leasing, we're going to be able to de-lever the company in the near future and obviously we're all focused on generating positive cash flow and we're working towards that goal.

Philip A. Cusick

JPMorgan Securities LLC

Q

Okay. Thank you.

Operator: And your next question comes from Jennifer Fritzsche with Wells Fargo.

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Q

Thanks for taking the question. Two, if I may. One, Marcelo, I wanted to ask you about churn, obviously, record low. Can you talk about the involuntary impact on that churn? It's my understanding you've tightened credit checks and I just wanted to confirm that.

And secondly, a question for Masa. Masa, if you see the changing landscape of what AT&T and Verizon are clearly doing in bringing video as part of the wireless bundle, how do you feel Sprint can compete there? Are there kind of more things you can pull out or is it more on speed and the network that you see as your point of differentiation? Thank you.

R. Marcelo Claure

President, Chief Executive Officer & Director

A

So let me start with the churn. We feel extremely proud that we've had two consecutive great quarters from churn and I think it's important that when we reach 1.56% churn, that was down 49 basis points year-over-year. But I think more importantly, it's something that the entire team has to be very proud, this is the lowest churn in company's history. So this is not in the last two years, but since Sprint, the wireless group was formed, we have never had churn at this level, 1.56%.

What is nice is we're coming down on voluntary churn, on involuntary churn, in handset churn and pretty much every single churn measurement that we do. We have been coming down steady month-over-month and quarter-over-quarter. What that tells you is that customers are having a much better experience, the network experience is much better, customer experience is better, and overall, there's a customer-centric focus to make sure we take good care of our customers. So we feel very good about 1.56% and we will continue to see a trend of improvement year-over-year in the following quarters. Maybe Masa start and then maybe I'll comment after. Go ahead, Masa.

Masayoshi Son

Chairman

A

On the video bundle, I say that in the U.S. all of the four mobile carrier network is congested, all of them, very badly. It's so bad that you don't want to even talk about the detail. So in that situation, how would the customer

benefit for video bundle? Video bundle, especially through the mobile network is going to even choke the network. The network congestion becomes even worse. So I think before you talk about video bundles, especially through the mobile network, all of the four carriers in the States have to cure the issue of congestion. That is more fundamental to the basic service of the network itself. That's my comment.

R. Marcelo Claure

President, Chief Executive Officer & Director

A

From our end, we look at, they are just different strategies. We look at what Verizon is trying to do is something that mobile operators around the world have tried many times and that is to try to launch OTT or different services. And unfortunately, the track record of success of carriers around the world in terms of behaving or bringing this over-the-top solutions have not been stellar. So we're watching and we believe that anything that's being done can be replicated through partnerships rather than also having to buy assets in video or content. Most of the content that Verizon is getting is non-exclusive content and that's available to most.

So therefore, we think we can get to a similar situation once we're able to strike the right amount of partnerships. And I think it can leverage on one of Sprint's biggest strengths which is because of the size of the spectrum we have, we believe to be leading basically in capacity, which is something that is quite important as you deliver video to your customers.

Jennifer M. Fritzsche

Wells Fargo Securities LLC

Q

Thank you both.

Operator: And your next question comes from Brett Feldman with Goldman Sachs.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

Thanks for taking the question and also thanks to Joe as he's getting ready to move on. You've just been so helpful over the years to the investment community. So, two quick questions. One, just to clarify, you talked about potentially setting up a leasing model for your network. Are you talking about something as significant as maybe transferring ownership of the network and leasing it back, for example, from a REIT? And then, Marcelo, you mentioned some of the new distribution channels like RadioShack and Direct 2 You. How would you qualify the productivity of those channels? Are they fully up and running at this point or do you expect them to be more significant sources of gross adds over the coming quarters?

R. Marcelo Claure

President, Chief Executive Officer & Director

A

So, I will start with distribution and then there's not a lot that we can talk about in the network leasing company, but I'll let Masa elaborate if he so chooses. As it relates to RadioShack, we basically – as we needed to expand distribution and all of you know how expensive it can be from a capital expenditure and from an operating expense if you want to massively densify your distribution grid. So we found in RadioShack a great way to get in, expand our distribution. We were severely under-distributed, and grow to 1,435 stores with potentially the lowest capital expenditure as the only thing we had to invest was in signage and fixtures. So that allowed us to go into many places very fast at a very low cost.

Also from an operating expense perspective, the fact that we have one to 1.5 salespeople in one of those stores as we're leveraging the RadioShack sales force allow us to have a very low cost of operating, therefore, cost to

breakeven is relatively low. I'm happy to report that we are ahead of our plan in RadioShack. We have all 1,435 stores that have started selling Sprint products and services, and sales continue to grow week over week. As it relates to Direct 2 You, we have rolled this out to over 30 different markets in the U.S. We have over 600 different cars today basically delivering mobile phones or taking the in-store experience directly to customers throughout the United States.

In addition to our 2,100 Sprint-branded dealers and 1,100 company-owned, we feel at this point in time that we have the proper distribution grid in order to be able to fulfill the demands of our customers. As it relates to the network leasing company, we have discussed, at this point in time it's premature to speak about details. Obviously, we're working with SoftBank and other partners to potentially establish a leasing company. This is in very early stages and we're going to provide more details in the future as this comes to realization. And obviously, we're evaluating for this to be on or off balance sheet at this point in time.

Brett Joseph Feldman
Goldman Sachs & Co.

Q

Great. Thank you for taking the question.

Masayoshi Son
Chairman

A

So, let me a little bit on top of that. The cost of the leasing facilities that we are preparing together with Sprint would be effective interest rate is lower than the highest bond that Sprint has been issuing in the recent period. So it will be lower cost than the high-yield bond. So it should help Sprint's financial results. And then by preparing this, as Marcelo said, it will eliminate the need of additional bonds or equity financing.

Brett Joseph Feldman
Goldman Sachs & Co.

Q

Great. Thank you.

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

Masayoshi Son
Chairman

A

Let me clarify once more. When I say additional bonds, Sprint is not going to increase from today's out bond, out net debt, so of the bond outstanding. So it may do just a replacement of the existing ones. So that may continue, but not incremental. So that's what I meant.

Amir Rozwadowski
Barclays Capital, Inc.

Q

Thank you very much for the clarification, Son-San. In thinking about your commentary around cash burn, it seems as though you feel that this year is the year where we'll sort of peak on cash burn. How should we think about your comfortability on that in terms of the levers? I mean, clearly, the financing activities that you have in place should provide some relief to some of the pressures associated with handset leasing. But I would love to get some more color in terms of how you think about the incremental savings that you expect to get out of OpEx going forward? I know that there was an initial plan put in place, and would love to hear how much progress has been made along that initial plan, and how should we think about the incremental opportunities going forward?

Masayoshi Son

Chairman

A

Yes.

R. Marcelo Claure

President, Chief Executive Officer & Director

A

So let's talk a little about – Masa, I'll take that one. Let's talk a little bit about the cost takeout, right? We were very firm when we started this journey that we were going to take over \$1.5 billion of costs in 2015. I'm pleased to report that we are on track to achieve that and exceed that. We have reinvested some of that in some of our growth opportunities like RadioShack, Sprint Direct 2 You and others and other network improvements. Going forward, we feel that we're going to take out the same or more and we have initiated a very aggressive transformation office and we're going to continue to look at every process that we have and we plan to take out significant cost out of the business in order to minimize the cash use as it relates to expenses.

We're clear on – we understand the importance to get to free cash flow positive as soon as possible, and we're working very diligently towards that goal. And what's important is that this was the year in which we hit the top of the cash flow burn and have a plan to substantially improve the company's cash position in the future. So when you combine the cost takeouts and the new leasing arrangements that we have, we feel very comfortable that we have the proper funds to continue to fund the turnaround of Sprint.

Amir Rozwadowski

Barclays Capital, Inc.

Q

Thank you very much, Marcelo. And then, if I may, one follow-up. You've discussed sort of the lack of a need to tap the capital markets here. I was wondering, when you look at your spectrum portfolio position, obviously, we've got a significant potential spectrum auction coming up as early as the first half of next year. How do you think about strategically the spectrum portfolio over the next several years? Are you comfortable with where your portfolio stands today, or is there a requirement for you to expand sort of your portfolio on the low band side? Thank you very much.

R. Marcelo Claure

President, Chief Executive Officer & Director

A

So the way we look at this is we're building a great network based on our existing rich spectrum portfolio. And since the 600 megahertz will not be commercially available potentially around 2020, we have to work with the spectrum that we have today. We said about 600 megahertz provides an opportunity to acquire low band spectrum. However, we want to make sure that before we make a decision, we've got to understand the rules. And we want to make sure that the rules are something that are going to make it worthwhile for Sprint to participate. So at this point in time, I would say, it's premature for us to speculate today on how we will respond if we were to acquire additional spectrum. So at this point in time, our position is we want to understand the rules, and then we're going to make a decision on how do we proceed forward.

Amir Rozwadowski

Barclays Capital, Inc.

Q

Thank you very much for the incremental color.

Jud Henry

Head-Investor Relations

A

Suret, we have time for one final question.

Operator: And your final question comes from Jonathan Chaplin, and he is with New Street.

Jonathan Chaplin

New Street Research LLP (US)

Q

I'm wondering if can ask Phil's question to Masa Son in a slightly different way. Do you see strategic value in maintaining the stub, the public equity stub in Sprint out there? And then secondly, on the financing vehicles, how much do you expect to raise over the course of the next couple of years in total in the two vehicles? And if you did participate in the spectrum auction, would you be able to put spectrum into one of these vehicles, or a similar kind of vehicle? Thank you.

Masayoshi Son

Chairman

A

The size of the leasing facilities is going to be significant size, and it will be enough size to offset the needs of the handset lease sales requirements. And for the next generation network CapEx, again, would be with this preparation of leasing facility should be enough to cover the needs of the next generation network CapEx. Regarding the next spectrum auction, it's too early to make a comment, things are still unclear on the government side so it's too early to make a comment. But because of the cost down in OpEx and also because of these two leasing facilities that we are preparing, the interest-bearing debt should start to decrease. So from our experience that we have done Vodafone Japan acquisition, initially, net debt over the EBITDA ratio was six times. So our leverage was very high. Sprint is right now five times. So SoftBank started even higher leveraged ratio position and then very quickly we reduced the total size of the debt. Of course, we also did network – the handset accounts receivable securitization and so on, similar to this lease facility effort. So we became 1.0 instead of 6.0 in terms of the leverage ratio over the EBITDA.

I am very confident that Sprint interest-bearing debt multiple will be decreasing very quickly, very significant. So this is the same path that we have come in the past, so I'm confident with Marcelo's leadership and our joint effort we will be able to improve dramatically from here on.

Jud Henry

Head-Investor Relations

That's all the time we have for questions. So before we end the call, I'd like to turn it back to Marcelo for some closing comments. If you have additional questions following the call, please contact the Sprint Investor Relations team at 1-800-259-3755 or investor.relations@sprint.com. Marcelo?

R. Marcelo Claude

President, Chief Executive Officer & Director

Thanks, Jud. I want to thank everyone for joining us today, including thanks, Masa, for participating in this call and for reaffirming your full support of Sprint. This definitely was a milestone quarter in the company's history as we returned to positive postpaid phone net additions within the quarter for the first time in two years, as well as posting the lowest postpaid churn rate in the company's history. We're excited about how our network keeps getting better every day, and we look forward to seeing our network improve to a whole new level over the next couple of years through our densification plan. Most importantly, we plan to continue to aggressively take cost out of the business by simplifying the way we operate, and we feel good about our ability to leverage our business relationships and assets to fund this turnaround.

I'm confident that we're on a path to return Sprint to growth, profitability and ultimately free cash flow positive. Thank you.

Masayoshi Son

Chairman

Thank you very much.

Operator: Thank you for participating in today's conference call. You may now disconnect.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2015 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.