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Sprint Corp. (S)

Q2 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, and thank you for standing by. Welcome to the Sprint Fiscal Second Quarter 2014 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 today's conference over to Mr. Brad Hampton, Vice President of Investor Relations. Please go ahead, sir.

Brad Hampton

Vice President-Investor Relations

Thank you, Tinazia. Good afternoon, everyone, and welcome to Sprint's quarterly earnings call.

Before we get underway, let me remind you that our release, quarterly investor update and presentation slides that accompany this call are all available on the Investor Relations page of the Sprint website.

Slide two is our cautionary statement. I want to point out that in our remarks this afternoon 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 three, 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 on slide four. As announced earlier this year, Sprint changed its fiscal year into March 31 making this our second fiscal quarter of 2014. However, for ease of comparison to prior periods, any references to the quarter ended September 30, 2014, on today's call will be referred to as our third calendar quarter.

Financial results include a predecessor period for the third quarter of 2013 related to the results of operations of Sprint Communications, Inc. 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 third quarter 2013 results of operations for the predecessor and successor periods.

The following remarks related to the third quarter 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.

Net loss for the quarter was \$765 million compared to net income of \$23 million last quarter and \$383 million in the third quarter of 2013. In the quarter, there was \$284 million of severance and lease exit costs, which includes \$158 million related to the implementation of our recently-announced workforce reduction plan and an additional \$105 million for additional labor reductions we are announcing today.

Basic and diluted net loss per common share for the third quarter was \$0.19 compared to earnings of \$0.01 in the second quarter. Total depreciation and amortization of approximately \$1.3 billion for the quarter consistent with last quarter and compared to \$1.5 billion in the year-ago period.

Net tax expense was \$71 million in the third quarter. Lastly, although, Clearwire's financial results are now consolidated with Sprint's and included in today's presentation, its standalone quarterly financial results will be available on our website in the next several weeks as required by its debt covenants.

Joining us on the call today are Sprint CEO, Marcelo Claure; and CFO, Joe Euteneuer, and additional members of the management team available for Q&A.

I will now turn the call over to Marcelo.

R. Marcelo Claure

President, Chief Executive Officer & Director

Thank you, Brad. Good afternoon, everyone, and thank you for joining us on our call and for your interest in Sprint. Let me begin today by saying how glad I am to be here as being part of the Sprint team. I've now completed 85 days on the job and couldn't be more excited about the progress we've made in those few short weeks and the great future we're building out at Sprint, as we start our transformational journey.

On the call today, I'd like to share with you some of my initial impressions of the business, the actions we've taken as a result of those impressions and some of the encouraging early performance results we're seeing.

Joe will then take you through a quarterly financial results and updated outlook and I'll conclude with an update on our go-forward strategy before opening it up to your questions.

When I arrived as CEO of Sprint on August 12, I found a business facing some significant challenges, which have weighted on our financial performance. I'm confident, however, that we're taking the right steps to address these challenges and position the business for long-term success.

Turning to slide six, the overarching issue of facing the business when I arrived was our competitive value proposition. We find ourselves at a disadvantage on two fundamental drivers of purchase decision in wireless; price and network.

Our family pricing was confusing, complex, and not competitive on price. Customer perception of our network hadn't caught up with the actual performance improvement we've delivered. Additionally, the credit quality of the customer we were acquiring was below industry standards.

As a result, the company was in the weakest condition it has ever seen in terms of our share of gross adds in the market. Our performance across various key performance metrics showed the weakness. As I mentioned, our gross add share was depressed. We estimated that in August of this year, our share of postpaid phone gross addition fell to 10%. We were over-indexing tablet additions, which have less profit contribution, as well as the higher mix of sub-prime additions.

Our Sprint platform postpaid churn rate was at its highest level in over six years, as voluntary churn was pressured due to the competitive environment and the lingering perception of our network performance related to the construction process. Involuntary churn was pressured due to the higher sub-prime mix of gross adds during the year.

As a result, we were losing postpaid phone customers at a concerning rate. This year alone, through the end of the third quarter, we have lost over 1.8 million postpaid phone customers, more than 1.3 million we lost in all of 2013 when excluding the Nextel recaptures. Since phones have significantly higher output than other devices, the ongoing postpaid phone losses have obviously pressured our topline and hinder our ability to grow EBITDA. Compared to the third quarter last year, we had roughly 450 million of wireless service revenue pressure this quarter related to the loss of postpaid phones.

Finally, the Sprint brand was weak. We had no clear value proposition for consumers and as measured by an outside third-party or Net Promoter Score, a measure of our own customer willingness to recommend Sprint was the lowest among the four big wireless carriers.

These trends will not be reversed overnight. But it was clear to me that we need to act quickly and decisively. We had a long way to go in our journey and our first objective is to get back to retail net additions followed by postpaid net addition, which will mean more customers are finally coming to Sprint than are leaving. Then our goal next will be to get to postpaid phone net additions as those are the drivers of profitability.

If you turn to slide seven, you can see that we took immediate action. In my first week on the job, we tightened our credit requirements for new customers. While this immediately pressured gross addition volumes, it was the right thing to do as we expected to provide meaningful improvement in our involuntary churn rate and bad debt experience beginning in early 2015. Second, we repositioned the Sprint brand in the marketplace and created a simple and compelling value proposition for customers. We retired a complex family price plans.

Since we launched our new pricing on August 22, the Sprint now stands for the best volume wireless giving customers more what they want, high-speed mobile data for the same or better price as AT&T and Verizon. We

can now offer this value to individuals and couples with our unlimited plans and to families and businesses with our shared data plan, offering a lower monthly service charge and more data than the competition.

We also refreshed pricing for Boost and the Sprint prepaid brands, making them both more competitive in the marketplace and we updated our national advertising and promotional approach, reflecting the new value proposition.

Third, we strengthened relationship and go-to-market position with Apple, in advance of the iPhone 6, 6 Plus launch on September 19. We see consumer demand for Apple product remaining high and we made some strategic moves to better position ourselves in that market.

For the first time ever, we launched an exclusive rate plan for the iPhone, and an innovative and industry-first leasing option for customers to acquire the iPhone, or iPhone for Life Plan. Our exclusive \$50 all-in unlimited rate plan combined with a phone leasing option, starting at \$20 per month, gives qualified consumers the lowest cash out-of-pocket at the point of sale and the lowest total cost of ownership in the industry for a new iPhone.

Please turn to slide eight. I'm pleased to report today that we're seeing very encouraging early performance results from the change we implemented. Although, one month shows significant change in the subscriber trends, it is only a short time, so let me summarize some of the key trends.

Gross adds, we have seen a notable turnaround in our postpaid phone addition trends. In the month of September, we delivered our highest monthly postpaid phone gross addition since December of 2012. Representing nearly 40% increase over a monthly run rate through August this year. And in October, we grew another 7% sequentially. September represented the first month in 2014, where we deliver year-over-year growth in phone net adds. We're up 27% in September and 31% year-over-year in October.

From a credit perspective, we achieved that growth in high quality prime customers after a lift in prime gross addition more than offset the decline in sub-prime additions related to the credit policy changes. September represented our highest prime gross add mix in at least eight years.

We've also seen a corresponding improvement in our competitive porting ratios. I'm happy to announce that since the launch of the new iPhone models, we have been postpaid net port positive in total against our competitors.

We're especially pleased with the appeal of our Sprint Family Share Pack rate card as we increasingly see whole families switching to Sprint to take advantage of the great value. For accounts porting the Sprint on the Share Pack, we saw more than eight times increase in accounts with three or more lines compared to our multi-run rate prior to the pricing changes. These are high-value prime customer, who should improve our churn and profitability performance over time.

And finally, we had our most successful iPhone launch in company history and we're seeing continuous strong demand. Most importantly, we're also seeing improved engagement from our base. For the four weeks following the launch of the new iPhone model, we saw nearly 2.5 times increasing customers from our base upgrading to the new models compared to last year's launch, a sign that customers are choosing to stay with Sprint.

We're also seeing a strong customer adoption of the iPhone for Life Plan. As you can see, in a few weeks time, we started making progress in addressing the challenges facing the company and significantly slowing the loss of postpaid phone customers. While we're encouraged with the results over the last few weeks, by no means have we turned the corner. This is a dynamic market and our competitors clearly aren't standing still.

Joe will now take you through our financial results.

Joseph J. Euteneuer
Chief Financial Officer

Thank you, Marcelo. I'm very excited to be part of the transformation you mentioned. As you can see, we have been very busy over the last 85 days and we are running the day-to-day operations very differently. The entire senior management team is engaged in daily meetings focused on our top priorities and we are acting quickly as we begin this transformational journey.

Let me now take you through our financial results. I know that we have discussed with you previously and Marcelo already mentioned it today, but I want to remind you that losing postpaid phone connections for several quarters has created a headwind to our revenue and margins that will continue to impact results for some time. While these losses have persisted for several quarters, we were able to largely offset that impact with ARPU growth from smartphone penetration until recent quarters. I'll now walk you through our results for the quarter and our expectations for the remainder of the year.

Moving to slide 10, total Sprint platform net additions were 590,000 in the third quarter. Retail net losses of 237,000 improved 486,000 sequentially, primarily due to Assurance losses last quarter. Wholesale and affiliate net additions of 827,000 were the highest in nearly three years and marks the fifth consecutive quarter of growth in this business, as all segments within the wholesale grew within connected devices driving most of the gains.

Sprint platform lost 272,000 postpaid net connections in the quarter, driven by elevated churn levels. This is 88,000 better than the year-ago quarter and down 91,000 from last quarter. Postpaid phone net losses were 500,000 in the quarter, which were 100,000 lower than last year, but up 120,000 from last quarter, driven by early success of our new offerings.

Finally, tablet net additions were 261,000 in the quarter, up 207,000 year-over-year, but down 274,000 sequentially as we turned our attention to higher-value phone customers during the quarter. I think, it's important to note, the progress we've made since launching the new value proposition and the encouraging September and early October results Marcelo mentioned.

Sprint platform postpaid churn was 2.18% in the quarter, up from 2.05% last quarter, and 1.99% a year ago, primarily driven by higher involuntary churn as Marcelo discussed. While voluntary churn was elevated year-over-year, as a result of network and competitive pressures, we did see sequential improvement in voluntary churn. However, we do expect postpaid churn to be higher in the fourth quarter due to continued pressure in involuntary deactivations and a heightened competitive environment.

We also expect most of the involuntary deactivations to come through by the end of this year. We plan to focus on the key drivers of why customers are leaving us to improve the customer experience. As Marcelo mentioned, our top priority now is to get back to postpaid customer growth and given the trends we're seeing in the market today, we are optimistic we'll be able to deliver positive postpaid net additions in Q4.

In the quarter, 8% of our Sprint platform postpaid base upgraded devices, up sequentially and year-over-year, driven by the strength of our new pricing and the great success with the new iPhone launch. Furthermore, we expect higher sales volumes in the fourth quarter behind seasonally higher gross additions and record high upgrade rates which may be as high as 12%. The higher upgrade rates this quarter in the anticipation of our highest-ever upgrade rate in the fourth quarter are a good indication that our customers are recommitting to Sprint and the great value we provide.

Smartphones represented 95% of postpaid phone sales in the quarter and now account for over 86% of our postpaid phone base. In addition, we now have 62% of our Sprint platform postpaid base on LTE devices including 73% of our Sprint platform postpaid smartphone base. Also, postpaid devices finance declined to 27% this quarter and reached a low of 20% in August, before rebounding by double-digits in September and October.

Sprint platform prepaid experienced net additions of 35,000 in the quarter, driven by continued momentum on the Boost brand. In fact, Boost gross adds were the highest in nearly four years for the brand and the highest ever on the Sprint platform. In addition, the Sprint platform prepaid churn in the quarter of 3.76% was the lowest among the national carriers.

Moving to revenues, Sprint platform wireless service revenue of \$6.8 billion was down nearly \$200 million sequentially and nearly \$400 million year-over-year, driven by declines in postpaid service revenues due to continued losses of high ARPU phone connections over the course of the year. It is worth noting that the year-over-year decline in postpaid phone revenue was nearly \$500 million as a result of losses of phone connections, partially offset by growth in postpaid tablets and our wholesale base.

Wireline revenues declined 5% sequentially, driven by declining voice revenues, while the 19% decline year-over-year was a result of cable voice over IP migrations as we have noted in prior quarters. Voice volume declines and the annual intercompany rate refresh with the intercompany impact being neutral to consolidated adjusted EBITDA.

Sprint platform postpaid ARPU was \$60.58 in the quarter compared to \$62.07 last quarter and \$64.28 a year ago. The declines are primarily driven by higher tablet mix in the base as well as migrations to unsubsidized rate plans. 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% sequentially and 2% year-over-year. Sprint platform prepaid ARPU of \$27.19 was relatively flat sequentially and up 7% year-over-year, primarily due to the purchase price accounting dilution included in the year-ago period.

Please turn to slide 12. Consolidated adjusted EBITDA of \$1.4 billion was up 3% from the year-ago period and down \$441 million sequentially. The year-over-year increase is driven by wireless adjusted EBITDA of \$1.37 billion, which improved by over \$160 million. This year-over-year change was in spite of the rate and volume declines in service revenues of over \$400 million that I just discussed.

Net subsidy improved by over \$100 million as equipment revenue was up \$329 million year-over-year, primarily due to the introduction of installment billing for devices, while the cost of products increased \$219 million mostly due to higher postpaid volumes and higher iPhone sales, which were up almost 40% year-over-year. Even after adjusting for the impacts of installment billing accounting, wireless adjusted EBITDA grew by double-digits year-over-year.

Additionally, as Marcelo said earlier, expense reduction is a priority and we have made notable progress in taking cost out of the business over the last year. Wireless cost of service decreased \$339 million year-over-year, due to lower roaming expenses and lower backhaul expenses as a result of the network modernization.

Wireless SG&A expenses decreased over \$115 million year-over-year, driven by continued reduction in care expenses through operational efficiency, as well as, lower selling expenses, partially offset by higher bad debt expense. The lower selling expenses are a result of continued streamlining of the sales organization as well as improved channel mix and lower average commission rates combining to offset higher sales volumes. The increase

in bad debt primarily reflects the impact of increased accounts receivable associated with customers who have elected to finance the purchase of their device through the Sprint Easy Pay plan.

Sequentially, the decline in wireless adjusted EBITDA was driven by a \$200 million decline in postpaid service revenue, as a result of the cumulative and in-period loss of postpaid phone connections along with \$300 million in higher net subsidy expense, as a result of higher sales volume, a higher mix of iPhones, and a higher mix of customers selecting a subsidized purchase.

Wireless cost of service improved sequentially by \$61 million, primarily as a result of backhaul savings as we continue to migrate to Ethernet and eliminate T-1's as well as lower service and repair expenses.

Wireline adjusted EBITDA declined year-over-year to \$27 million, driven by cable voice over IP migrations, lower volumes and the annual intercompany rate refresh, which is neutral to consolidated adjusted EBITDA.

Consolidated operating loss of \$192 million was worse sequentially by \$700 million and improved by more than \$200 million year-over-year. This sequential change was due to the decline in EBITDA and the severance charges in the quarter, while the year-over-year improvement is due to the improvement in wireless EBITDA as well as lower depreciation and amortization expense.

Moving to slide 14, we ended the quarter with a total liquidity position of \$8.8 billion, including cash, cash equivalents and short-term investments of \$5.3 billion, as well as \$3.5 billion of undrawn borrowing capacity under our revolving bank credit facility and eligibility under our undrawn service receivables financing agreement at the end of the quarter.

In addition, we have recently revised the terms of our revolving credit facility to provide us greater flexibility and liquidity options, as we focus on improving our customer trends and invest in our network. As we look ahead, we have no significant maturities due until December of 2016. We will continue to manage our capital structure and position ourselves to have adequate liquidity to grow the business and fund investments in the network.

In the short-term, we will work on closing the vendor financing on the 2.5 GHz build and look to put in place an installment billing facility. As always, we will continue to rely on our ability to access the market for all available forms of liquidity.

Capital expenditures of \$1.5 billion in the quarter were up slightly sequentially as growing momentum of the 2.5 GHz build offset continued decline in Network Vision expenses. Year-over-year capital expenditures are down \$300 million as the heavy spending on Network Vision a year-ago is only partially offset by higher spending on Sprint's Spark deployments which are less capital-intensive.

Free cash flow was negative \$75 million for the quarter compared to negative \$909 million for the year-ago period and negative \$496 million last quarter. The year-over-year improvement was due to lower working capital spend and lower CapEx, partially offset by higher cash interest payments. Sequentially the improvement is related to higher cash flow from operations, decreased cash paid for CapEx, and higher accounts payable.

Within working capital, we did have \$818 million included in accounts and notes receivable related to installment billing. Total net receivables related to installment billing were \$1.2 billion, up from \$1 billion at the end of last quarter.

Now, I'd like to provide an update on guidance for the remainder of calendar year 2014. Since we provided guidance on our last earnings call, we have seen a number of changes in the business as Marcelo discussed. The

continued trend of postpaid phone losses we have experienced creates a headwind to service revenues that will impact the remainder of this year and next year. However, our improved value proposition is resonating in the marketplace and we expect significantly higher sales volumes in the fourth quarter behind seasonally higher gross adds and upgrade rates as high as 12%.

While the new offers should start to increase the mix of customers electing installment billing or leasing, the volume will still drive significant cost in the fourth quarter, while being accretive over the long-term. As a result, we expect fourth quarter consolidated adjusted EBITDA to be lower.

Turning to slide 16, along with the cumulative impact of our phone connection losses through the end of the third quarter, and the higher expected sales volumes in the fourth quarter, we now expect full-year adjusted EBITDA to be between \$5.8 billion and \$5.9 billion. We are obviously still early in our transformation, but we expect the same two forces to impact adjusted EBITDA in 2015: higher anticipated customer acquisition cost; and the service revenue declines from the cumulative postpaid phone losses.

Given that Marcelo has only been here 85 days, we are not prepared to give formal EBITDA guidance for calendar year 2015; however, other than to direct you to the EBITDA in 2015 being neutral to modestly higher, compared to 2014.

From a capital perspective, we continue to focus on the 800 MHz and 2.5 GHz LTE overlays. This increased pop coverage and LTE capacity has allowed for migration of data traffic to LTE, which has reduced the expected investment in 3G capacity. Also, we are seeing lower maintenance in capitalized labor spending this year. Furthermore, just as we evaluate every dollar being spent on operating expenses, we employ a similar focus on capital expenditures to maximize our capital efficiency.

As a result, we expect our capital expenditures for the year to be below \$6 billion. However, our expected spending on the 800 MHz and the 2.5 GHz deployments remains on track and we remain committed to meeting or exceeding our original deployment targets for this year.

As you can see, the changes that we have made since Marcelo started are all consistent with this mission of building long-term value. This momentum will serve us well going into 2015 and I am excited to be part of this transformation.

I'll now turn the call back to Marcelo.

R. Marcelo Claire

President, Chief Executive Officer & Director

Thanks, Joe. Turning to slide 18, I'd now like to give you an update on our go-forward strategy. As I said at the beginning of the call, I've only been the CEO for Sprint for 85 days, so our strategy is still evolving and will take some time to take hold, but let me share where we are now.

First, let me lay out my approach to managing the company. I'm here to run Sprint for long-term value creation. I'm establishing priorities and goals for the company that will drive value. Some of these priorities may produce some near-term pressure on our financial results, but we're going to manage for the long-term and then focus on delivering long-term shareholder value.

Now let me outline our priorities for 2015. I have identified four strategic focus areas that are most important looking forward. First is our competitive value proposition. As I mentioned earlier, our brand is now positioned to

deliver the best value in wireless and we're committed to being a nimble and aggressive competitor in the marketplace. Our first improvement plan objective was to grow our share of gross adds. Our next focus will be on improving churn. We're intensely focused on better understanding our customer base and eliminating the reason why they're leaving. I've initiated a company-wide program that will address the top three reasons customers tell us they're leaving; network, pricing and customer experience. I've also tied executive compensation to this effort to drive the appropriate focus on lowering churn.

Second is our network, we're focused on providing our customers with the network that works where and where (sic) [when] (29:37) they want, including delivering improved voice and data quality, while focusing on consistency of the customer experience. We're seeing marked improvement in our network performance as evidenced by third-party data.

Preliminary results by independent mobile analytics firm RootMetrics for second half 2014 shows Sprint achieved significant year-over-year improvement in all aspects of network performance. The Sprint's network received 94 first place or shared first place Root score awards for reliability, call and our text performance in cities across the country. We're also intensely focused on completing the build out of our tri-band LTE network. Let me give you a quick status update on the build and our expectations for the rest of 2014 and 2015.

At the end of the quarter, our LTE coverage is now available to 260 million of the U.S. population in over 500 cities. On our 800 MHz spectrum we continued to make good progress. We expect to be substantially complete with nationwide deployment of voice service on the 800 spectrum band by the end of this calendar year and have now reached 50% of our total LTE footprint. We expect to be substantially complete with our planned 800 MHz LTE build by the end of 2015 in markets where the spectrum is available. For the 2.5 GHz spectrum LTE build, we remain on track to cover 100 million pops by the end of this year. I'm happy to report that we have already reached coverage for 92 million pops.

During 2015, we're going to continue to expand our 2.5 GHz LTE coverage in cities around the country prioritizing markets where we have highest usage and capacity demand. Second, we will focus on a customer targeted build of our network. This approach will allow us to begin marketing the network experience in those markets sooner than waiting for all markets to reach a critical mass of completion and will provide us proof of concept to learn from and optimize as we plan to build in other major markets. Third, let me talk about cost structure. Our margins are out of line with our competitors and they're under further pressure as we have seen the ongoing impact of phone customer losses on our revenue profile.

Improving margins will require both increased scale and growth in the top line as well as cost reductions in the business to drive the bottom line. Because of this, we have begun a comprehensive review of all aspects of our cost structure. We're evaluating every dollar spent and for the first time in many years are taking a zero based budgeting approach to the business.

I have appointed a full-time senior level officer in the company, who is responsible for leading this effort and driving out cost. I meet with him and his team every single day to review different opportunities to eliminate costs.

We plan to eliminate at least \$1.5 billion of cost on an annualized basis compared to our 2014 spend rate. Example of costs, we've already identified to take out include product cost. We'll continue to leverage price on our SoftBank to lower our distribution and procurement cost, and we're evaluating process and our product policies and distribution. And early efforts have resulted in over \$100 million in expense opportunities.

IT and customer care simplification were driving efficiencies with back-office processes that we believe can yield up to \$150 million of savings. On labor costs, while we've announced some reductions in head count recently in

our network and IT organizations, our cost structure analysis indicates that we regrettably, we need to make some additional reductions.

Today, we're announcing that we'll be eliminating approximately 2,000 additional positions from our workforce. While difficult, this move is necessary for Sprint to compete in the marketplace. We now expect total labor cost savings of \$400 million on an annualized basis, which will include internal and external labor.

While we're announcing cost reductions, we're also selectively investing in areas of the business that will help us drive growth. As an example, I believe that it's important that we have a call center serving our top customers located on our headquarter campus in Overland Park. We intend to bring the best, highest-level customer service representatives to this new center.

So today, we're announcing that initially we will hire 200 representatives to work in this center and I anticipate this number will continue to grow. They will bring their dedication and leadership as we make sure we deliver superior customer service to our highest value customer, this is our demonstration of our unwavering commitment to our hometown region, as well as contributing to our efforts to improve the customer experience.

Finally, our people; when I arrived at Sprint, we initiated a management review and have decided to make some leadership changes as we look to the journey that lies ahead. We've announced some changes recently and more changes are coming. Leveraging internal and external talent as well as key resources from the SoftBank family, we're building the right leadership team to take Sprint forward.

Let me close with a few words about the road ahead and the new Sprint. As I step back and look at the wireless industry, one thing has really resonated with me over the last few weeks; the overall level of discontent among wireless consumers. The industry touches the lives of nearly every household in the country. American consumers love their phones, but they have little love for the carriers.

Part of the reason for this is the way the industry communicates with customers. Marketing and advertising are overly complicated and create purposely confusion with customers. In fact, I challenge some of the bright financial minds on this call to read through the product offerings and watch TV advertisement and determine which provider's plan other than Sprint offered the lowest total cost of ownership for wireless. We're going to change that with the new Sprint. As we offer the best value in wireless, we're going to offer consumers three things; value, clarity, and simplicity. Our first small step to provide that was our very popular iPhone for Life Plan. This plan embodies the new Sprint, a unique product that offers a high value and is easy to understand.

Needless to say, this is just a beginning. You're going to see a battle of new offerings that provide consumers what they want and what they deserve: clarity, simplicity, and value. We're excited about these new offers and I look forward to speaking to you all again as we see the results.

I will now turn the call over to Brad to start the Q&A session.

Brad Hampton

Vice President-Investor Relations

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

QUESTION AND ANSWER SECTION

Operator: Okay. [Operator Instructions] And we'll pause for just a moment to compile the Q&A roster. Okay. And your first question comes from the line of Jennifer.

Jennifer M. Fritzsche
Wells Fargo Securities LLC

Q

Great. Thank you. It's Jennifer Fritzsche with Wells Fargo. Thank you for taken the question. Marcelo, I just wanted to ask about, it seems like there has been a lot of confusion regarding your 2.5 GHz strategy and now low CapEx. Can you talk about, are you still looking to do kind of a three to five market denser build or is this something that [ph] consider buying after that (37:17) proof of concept deploying on a more nationwide basis?

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Okay. So, let me take the first part and then I'm going to pass it to John Saw, so he can complement my answer. From a network deployment strategy, we have a three-step approach, right? At the beginning, the first step is we got to complete our 800 MHz LTE deployment. That is crucial to provide great coverage to our customers, especially to enhance or in building coverage; that's step number one.

Step number two is, we have a privileged position that we want to leverage our 2.5 GHz to address capacity and congestion issues that every network in America faces, so we're going to be laser-focused on resolving that.

And step number three is a continuous deployment of our 2.5 GHz spectrum and we're going to continue to do that. We're going to be by the end of the year at 100 million pops, where 92 million pops, and what we're doing is, we're accelerating the deployment in what we call a customer targeted deployment. And that means we're going to start in three to five markets, where we're going to densify the network, but then after that we're going to continue to roll over through the country. So, yes, we're focused on the initial stage to complete the three to five market, but that doesn't mean – we want to clear the confusion – that doesn't mean we stop there. We will continue to deploy the 2.5 GHz spectrum that we have. And I'll pass it to John Saw, if he wants to complement my answer.

John Saw
Chief Network Officer

A

Yeah. So, Jennifer, so we're going to be very busy with 2.5 GHz builds. As Marcelo say, we have made great progress so far. We are at 92 million pops covered now. Those are going to address the areas where you have congestion and where there's demand for bandwidth. And then, like Marcelo said, the customer targeted deployments is going to follow. We're going to start by identifying a few markets, but that's going to grow over time as we look at this as proof of concept, so we're going to be busy with the 2.5 GHz build.

Jennifer M. Fritzsche
Wells Fargo Securities LLC

Q

Great. Thank you.

Operator: Your next question comes from the line of Michael Rollins.

Michael I. Rollins
Citigroup Global Markets Inc. (Broker)

Q

Hi. Thanks for taking the question. I was curious if you could talk a little bit more about the ARPU implications from the price promotions? And also, within that context, Joe, if I heard you correctly, I think you said that your initial indication for calendar 2015 is for OIBDA to be flat to may be slightly up, if I heard that correctly, but you're also targeting to annualize \$1.5 billion of savings, so could you talk about what the implications for revenue are given those two pieces of commentary that you provided today? Thanks.

Joseph J. Euteneuer
Chief Financial Officer

A

Sure. In regards to the last one, yes, you're right. We plan on taking \$1.5 billion of expenses out and as you recall from our guidance on the thing related to the cumulative loss of subscribers. So, when you think about the cumulative loss of subscribers, we felt in the first three quarters, that impact carrying over to next year, we needed something to offset that and that's going to be the expenses we're taking out combined with this new volume growth that we weren't anticipating. So, when you look at 40% growth in volume of gross adds, et cetera, and carrying that over to next year, those are three things that have a direct impact to the bottom line.

And on your first question on ARPU, I think the way to think about or if you're referring to the rate changes and in comparison to subsidy, our goal on that is, one, to continue to try to drive people to installment billing and leasing programs. And to the extent we do that, that eliminates the subsidy and offsets any of the impact based on the rate changes that we put out in the marketplace, so it's a net neutral for the company.

Michael I. Rollins
Citigroup Global Markets Inc. (Broker)

Q

Thanks very much.

Operator: Your next question comes from the line of Amir.

Amir Rozwadowski
Barclays Capital, Inc.

Q

Thank you very much, and good afternoon, folks. Just wanted to follow-up in terms of some of the commentary around the postpaid net add activity. It sounds as though you folks are expecting positive postpaid net adds, given the recent trends that you've seen around some of our promotional activity. I just wanted to clarify, is that around postpaid phone net adds in the fourth quarter or is that sort of total including some of the tablets? That would be helpful.

R. Marcelo Claure
President, Chief Executive Officer & Director

A

Amir, we're trying to manage the company as you've seen from the trends that we've showed you. We want to get first to a postpaid net add activity and then later on move to a postpaid phone net add, right, we've made great improvements. September was a record month for the company. October was another record month for the company, but it's a competitive environment out there, so that's what we're trying to manage to.

We have seen an increase in postpaid phone net additions and we have seen a decrease in net tablets. And to share that with you, that's been because we're putting a lot more focus on becoming postpaid phone net add positive, because as you know, this is main profitability and the main driver of profitability in the business.

Amir Rozwadowski

Barclays Capital, Inc.

Q

Thank you very much. That's helpful. And then one quick follow-up, following on the prior question around the annualized cost reductions. It sounds as though you're very focused on driving some of these costs out of the business. I was just trying to assess, are these initiatives already in place? Or are they initiatives that you are hoping to sort of target over the coming months to drive down costs? And I guess, what I'm getting at is, do you have pretty good visibility when it comes to that sort of \$1.5 billion in cost savings? Thank you very much.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

Thank you, Amir. And that's a very good question. So, we have been from day one, we have said there are three priorities, which was to improve our value positioning and focus on cost, definitely and improving our network. And cost has been a driver from day one.

So, we meet on a daily basis, so you can be certain that we have identified most of the \$1.5 billion. And I think, more importantly, we're making a commitment to take out \$1.5 billion of costs, so we're looking at the business from an end-to-end and pretty much every dollar that's being spent is being properly scrutinized to make sure that we can hit the objective of lowering \$1.5 billion, so we can continue to grow, . And most important that we can fund our growth.

Operator: And your next question comes from the line of Kevin Smithen.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

Hi, I wonder if you could talk a little bit about your cost of products line? I guess, we would've expected a little bit more of an EBITDA benefit from EIP in this quarter and presumably, your mix shift is more towards subsidies than you would expect. Can you elaborate on that a little bit and talk about what subsidy you're accruing on the EIP plans, kind of mix shift assumptions pre and post-iPhone launch, and what you're expecting for – you talked about gross adds up 40% in 2015. Can you talk a little bit about your mix assumptions on EIP for next year?

R. Marcelo Claire

President, Chief Executive Officer & Director

A

Okay. So, let's start with the mix between EIP versus subsidy. When I came on the company on August, we had the lowest EIP mix over the last few months. I think it dropped all the way down to 20%. Since then, we have taken the appropriate actions and we have moved to an Easy Pay and we have introduced our leasing and we have seen a great takeout rate increase of a percentage of mix, EIP, it's composed of leasing and of Easy Pay. So, we're moving in the right direction.

It's fair to say that we are at the highest we have ever been, primarily in our company-owned stores where we have a lot more control over the behavior and a good indication that leasing is working relatively well is that Best Buy just launched this weekend, our leasing programs and we're rolling out all the national retailers throughout the course of the year.

Our dealers are performing extremely well on leasing, so I can tell you that we're at the highest percentage of EIP the company has ever been. We're going to continually drive and our goal is to eventually make, most of our sales should come from EIP and why not – we're considering eventually eliminating subsidies sometime in 2015.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

Got it. But your EBITDA guidance, your informal guidance is assuming your current rate of EIP adoption that you've experienced in Q3 continues for next year?

Joseph J. Euteneuer

Chief Financial Officer

A

Kevin, it anticipates that we're going to get an increase of EIP and leasing going into next year, but you've got to also remember that we're talking about a lot more volume, so a part of that volume won't be on EIP and leasing and therefore it's a direct impact to EBITDA.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

Got it.

Joseph J. Euteneuer

Chief Financial Officer

A

Our volumes are far different than they've ever been. And combined with that, the prime mix has been phenomenal as a result of the changes we've made, so there are a lot of positive things that we've seen since Marcelo started that are long-term accretive, but have some short-term impact.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

And in terms of the mix, obviously the iPhone has an impact in September and in the fourth calendar quarter. Would you expect more of a mix shift away from iPhone to benefit subsidy expense and sort of the margin June quarters as we move into next year? Or do you think you'll continue to see a high iPhone mix?

R. Marcelo Claure

President, Chief Executive Officer & Director

A

I mean our goal is to provide the products that our customers want. And we're not going to manipulate market share among vendors. I think that is very different than what we've done in the past. Our goal is basically we make the product available for consumers and if consumers want to choose an iPhone, we're going to make iPhones available and the same with – they want Galaxy from Samsung, they want LG.

At this point in time, due to the aggressive launch of an iPhone 6, we have seen an abnormal high market share of Apple in our company-owned stores and in our dealers and we're going to leave it up to Samsung and Apple to battle it out – to battle for the consumers and our job is to make sure that we have those products in stock and that's what we're focusing on.

Kevin Smithen

Macquarie Capital (USA), Inc.

Q

So, just one follow-up. To ask a cost question a little bit differently, it sounds like your guidance for 2015, your informal guidance accounts for 40% increase in gross adds year-over-year and a higher upgrade rate. If gross adds were flat year-over-year, where would EBITDA come out with the \$1.5 billion plus in cost cuts?

Brad Hampton
Vice President-Investor Relations

A

Hey, Kevin. It's Brad. We didn't give specific guidance on gross add volume year-over-year. And then really we're just giving directional commentary on 2015 EBITDA, no specifics.

Joseph J. Euteneuer
Chief Financial Officer

A

Yeah, there's a lot more to come, Kevin. We're only 85 days into it.

Kevin Smithen
Macquarie Capital (USA), Inc.

Q

Okay. Great. Thank you.

Operator: Your next question comes from the line of Brett Feldman.

Brett Joseph Feldman
Goldman Sachs & Co.

Q

Thanks for taking the question. And just maybe to go back, you were talking about the traction that you've seen in September and into October. I was hoping we could just drill down into which offers you find are really resonating. Why are more people coming into the stores? Is it just because you're running more ads, or are you finding that the unlimited plans, in particular, or family plans, in particular, or leasing plans, in particular? Just trying to figure out, if there's an area where you're getting a lot of traction and maybe you could further accelerate your growth by emphasizing that as you move into 2015? Thanks.

R. Marcelo Claire
President, Chief Executive Officer & Director

A

Thank you. I think it's a combination of many factors, right? We've simplified our offering. I think consumers were a little confused about our Family offering, so the first thing that we did is, we brought back our unlimited rate plan. We did it with a special rate plan for iPhone and we did a special rate plan for the other phones.

Secondly, we eliminated Family, but we introduced our Family Share Pack. That is something American consumers obviously wanted as they were – as AT&T and Verizon spent billions of dollars advertising that, and I think our \$100 promotion has been very successful.

The way we look at this is we like customers to focus on a total cost of ownership and that's why we've introduced our leasing program that has a phenomenal uptake, so I think the combination of great plans and great ways to buy your mobile phone. I think that's what has allowed for customers to come and quite frankly to have great month in the month of September and October that has prompted competition to change their rate plans.

So, I think it's a combination of many factors and we're going to continuously advertise market the best value in wireless, which I think it's an area that we have a great value and still most of consumers don't know what a great value is, so you're going to see us be very aggressive in terms of advertising and letting American consumers that they should think of Sprint before they renew their contract with their other network provider.

Brett Joseph Feldman
Goldman Sachs & Co.

Q

And just a quick follow-up, since you mentioned that the mix of prime subs has improved, is that having any lateral benefit on your prepaid business? Many people coming into the store, they're interested in the new postpaid offers, they don't meet your higher hurdle, but you can put them into Boost or another prepaid offer?

R. Marcelo Claire

President, Chief Executive Officer & Director

A

I mean, I think that you can see we've announced that we have record additions on the Boost brand, which is the brand or it's a prepaid brand that we're pushing. We have also introduced Sprint prepaid into our stores and that's growing nicely. So, I think, overall, we have increased our credit requirement for postpaid and that's going to bring a lot of good momentum in our involuntary churn coming forward, I think our prepaid business continues to grow and September was a record month for our prepaid business.

Brett Joseph Feldman

Goldman Sachs & Co.

Q

Great. Thanks for taking the question.

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

John C. Hodulik

UBS Securities LLC

Q

Okay. Thanks. I just quickly had a follow-up, maybe for Joe. It was asked before, but I mean I didn't understand the answer, but what percent should we assume is in the guidance for the fourth quarter EBITDA, in terms of leasing and installment plan? If you could give us either of those, that would be great, or just sort of some directional information. And then maybe where that can go in 2015?

And then I guess, to Brett's question, Marcelo, you talked about the lower credit quality standards for last year and having tightened those up, could you give us a little bit more detail on when those were loosened or maybe what kind of percent of the base at this point is below your credit quality threshold and just to get a sense for how long this is going to take to sort of flush out of the system? Thanks.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

I'll take the second question, so I don't forget by the time Joe finishes his. We have a very healthy base of prime customers, it's a very healthy base. I think the requirements in the previous months, were a little – they were not as tight as I would personally like to see them and that was the first move that I took.

I'd say we're going to raise the quality of credit to the industry standards. We didn't want sub-prime customers to just come here as their only choice. So, we did that on day one. That was a calculated move that immediately reduced our sales dramatically; about four days later, we complemented with our new value proposition and the increase in sales has overshadowed the loss in sub-prime customers. So we feel very good about it. We like the quality of our customers.

The sub-prime base that we added in the previous month to my appointment, that is the main cause of why we have such a high involuntary churn and we expect that that's going to remedy. That takes three months to six months to remedy and you're going to see that come down in the first quarter of 2015.

But to answer your question is, we like where our base stands, we like the quality of customers that are coming to Sprint, we like the families that are coming to Sprint. They are traditionally prime families, so overall, the quality of customers is increasing, going towards in the right direction.

Joseph J. Euteneuer

Chief Financial Officer

A

And then, in regards to your first question, first and foremost, you should realize that we've got to give credit to our salespeople out there for all of the new plans that they been able to undertake, especially the leasing plan and how fast we got it up and implemented. And now as we try to get it soaked out into our other channels, it's been no small feat for the operating team to really get all of that done. And my hat's off to everyone at working as a team to get it done.

So, therefore, when we think about the growth in installment billing percentage and lease take rates, we did assume that it would go up at a consistent pace throughout the year. We've had some great success in turning it around from its low 20% in August to a number much better than that, but it will come as a gradual increase over time as what we assumed in the model.

Brad Hampton

Vice President-Investor Relations

A

Operator, we have time for one final question.

Operator: Okay. The next question comes from the line of Colby Synesael.

Colby A. Synesael

Cowen and Company

Q

Great. Two questions, if I may. The first one, dealing with the CapEx, less than \$6 billion, I recall, when you met with investors when you first started you'd indicated that this year would probably be the high watermark and that was only when it around \$7 billion in terms of expectations. Is the \$6 billion that you're referring to this year not probably the high watermark as we go forward into the outer years? And then my second question, I was just curious what you think of the strategic value of the wireline business? So, there's been a lot of speculation about what you may or may not do with that, and I'm just curious in the first 85 days you've thought about that? Thanks.

R. Marcelo Claire

President, Chief Executive Officer & Director

A

All right. Let's start with the CapEx question and then I can have my network team jump in. So, we said that we're going to spend a little less than \$6 billion and the reason for that is we've analyzed for responding and we figured that we didn't need to spend that amount of money we have projected for capacity on 3G and we're putting that money towards capacity on 4G and LTE. So, our expected spending of \$802.5 million remains on track and we're going to meet all our milestones. We have our lower maintenance and capital labor, and our customer targeted deployment makes the spending of money a lot more efficient.

So from that end we feel very comfortable that we are spending the money better and we are not scared to spend less money than we've committed. I look at it as a good thing as long as my network team is managing towards the metrics that we have given them.

As it relates to the wireline, I'm going to let Joe answer that question; but to answer your questions from a how do I look at it, we're undergoing a pretty deep review of wireline and that's something that we're going to come out in

the next few months and give you the latest status update on what exactly we're going to do with the wireline business.

Joseph J. Euteneuer
Chief Financial Officer

A

Yeah, I think, historically, we've answered the question that we entertained any possibilities of trying to use that asset in any type of deal or something like that, so we are opening our doors, always opening to talk to someone in regards to that asset. And although, it does take some work to separate it, et cetera, it is something that we're open to discuss.

Joseph J. Euteneuer
Chief Financial Officer

So, let me finish one by thanking everybody. It's quite exciting to be part of my first earnings call. I must tell you that we have started a transformation journey, while the company continues to face headwinds. We have begun the first phase of our transformation plan and I can tell you that I'm incredibly encouraged with the early results and I'm happy with what we reported this quarter, and I look forward to having more discussions as we continue with our progress.

Brad Hampton
Vice President-Investor Relations

Thanks, everyone. If you have additional questions, please contact the Sprint Investor Relations team. We look forward to giving you more information about Sprint as we deliver the best value in wireless.

Operator: This does conclude today's conference call. You may now disconnect.

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