Q4 2016 Earnings Call

Company Participants

- Brian L. Roberts, Chairman & Chief Executive Officer
- Jason S. Armstrong, Senior Vice President-Investor Relations
- Michael J. Cavanagh, Chief Financial Officer & Senior Executive Vice President
- Neil Smit, Senior Executive Vice President
- Stephen B. Burke, Senior Executive Vice President

Other Participants

- Anthony DiClemente, CFA, Managing Director
- Benjamin Daniel Swinburne, Analyst
- Brett Feldman, Analyst
- Bryan Kraft, Analyst
- Craig Eder Moffett, Senior Research Analyst
- Jason Boisvert Bazinet, Analyst
- Jessica Jean Reif Cohen, Analyst
- John Christopher Hodulik, Analyst
- Marci L. Ryvicker, Analyst
- Philip A. Cusick, Analyst
- Vijay Jayant, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to Comcast's Fourth Quarter and Full Year 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. Please note that this conference call is being recorded.

I will now turn the call over to Senior Vice President, Investor Relations, Mr. Jason Armstrong. Please go ahead, Mr. Armstrong.

Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, operator, and welcome, everyone. Joining me on this morning's call are Brian Roberts, Mike Cavanagh, Steve Burke and Neil Smit. Brian and Mike will make formal remarks, and Steve and Neil will also be available for Q&A.

As a reminder, as part of the FCC's anti-collusion rules for the Broadcast Incentive Auction, we cannot discuss or answer any questions related to the auction or spectrum today.

As always, let me now refer you to slide number 2, which contains our Safe Harbor disclaimer and reminds you that this conference call may include forward-looking statements subject to certain risks and uncertainties. In addition, in this call, we will refer to certain non-GAAP financial measures. Please refer to our 8-K for the reconciliation of non-GAAP financial measures to GAAP.

With that, let me turn the call to Brian Roberts for his comments. Brian?

Brian L. Roberts {BIO 1415772 <GO>}

Thank you, Jason, and good morning, everyone. I look back on 2016 with real pride and enthusiasm. Comcast NBCUniversal is a special company with a fantastic team working really well together, and we're executing an exceptionally high level. We had a terrific year and it ended on a real high note with our strong fourth quarter performance.

In the quarter: we added nearly 400,000 broadband subscribers; we're again Video net add positive; and we made important customer-friendly advancements, highlighted by the launch of Netflix on the X1 platform where we've seen an incredible first few months of sign-on activity and engagement.

Over at NBCUniversal, we capped off a strong 2016 with the box office success of Sing, and NBC is already off to another excellent start in the 2016-2017 TV season. So all-in-all, a great end to the year for Comcast NBCUniversal, and this provides strong momentum as we begin 2017.

For the full year 2016, we increased revenue 7.9% and operating cash flow 7%, and generated over $8 billion in free cash flow. The consistency and strength of our results enables us, with the support of our board, to announce a 15% increase in our dividend, our ninth consecutive annual increase. We are also announcing that we will split our stock 2-for-1, the 12th split in our company's history. Finally, we increased our share repurchase authorization to $12 billion and expect to repurchase $5 billion in stock in 2017.

Comcast NBCUniversal has an unrivaled portfolio of businesses that are working well together. So let me talk about some of our notable achievements in 2016, and then some of the things we're looking forward to for 2017 and beyond.

Starting with Cable, we added 161,000 Video subscribers. This is our best result and also the first time we have added Video subscribers in a decade, ending with almost 23 million strong. This is a fantastic accomplishment. To do this in the face of increasing competition and the rapid evolution in the category, speaks volumes about the team's innovative culture, focused execution, and the leadership position we've developed with X1.

Speaking of X1, we've now deployed it to approximately 50% of our residential Video customers and we're seeing continued impressive results. We'll keep driving X1 into our base and add features along the way to help further differentiate the experience as well as adding to our list of X1 licensing partners, which now includes Cox, Shaw and, most recently, Rogers.

In broadband, we added 1.4 million subscribers. This is the 11th year in a row that we've add more than 1 million. And, in fact, in 2016, we had our highest full-year result in nine years. All-in-all, at Cable, we added 858,000 net new customer relationships, which is up 29% year-over-year.

We have a great formula going with industry-leading products including the best in-home WiFi experience and the most complete video delivery platform. We also continue to make significant progress in our customer service, reducing customer calls handled by our agents by over 22 million in 2016, a double-digit improvement year-over-year. All of this is contributing to better customer retention and, therefore, extended customer life across each of our products.

In Business Services, we have really hit our stride, ending the year with a nearly $6 billion revenue run rate and great traction across all three of the customer segments that we serve, small, medium and enterprise.

At NBCUniversal, we had a fantastic year, further validating what a game-changing acquisition this was. As we've said before, operating cash flow at NBCUniversal has more than doubled since the announcement of the acquisition. And now, we can report that we have grown operating cash flow double digits each of the last four years; pretty great performance, in my opinion.

In our TV businesses, This Is Us is the year's breakout new hit series and a wonderful show. SNL is having its most-watched season in 20 years and we continue to rank No. 1 across day parts in broadcast, ranging from the TODAY show to Nightly News, all the way through to Late Night. And Telemundo beat Univision on many nights for the first time in its history.

In Cable Networks, USA was the number one cable entertainment network for the 11th consecutive year. MSNBC produced outstanding growth, and we ended the year with eight of the top 25 cable entertainment shows in the fourth quarter.

In Film, we knew in 2016, we had tough comps from the year before at Universal. We ended up with a wonderful year, with two breakout hits laying the groundwork for future franchises with Secret Live of Pets and Sing.

In Parks, the standout was in Hollywood, where our new Harry Potter attraction opened to tremendous guest reception and shattered attendance records. In addition, we continue to focus on growing internationally, creating a global platform that we expect to build upon for years to come.

Overall, our progress in 2016 sets us up incredibly well for 2017. So as we look to our priorities for the year, in Cable, we are focused on further strengthening our leading position in high-speed data, winning in Video, successfully bundling these and our other innovative products, expanding in Business Services, building upon the improvements we've made in customer experience.

While 2017 will involve an uptick in programming expenses, as Mike will detail, we expect programming cost growth to return to more normalized levels beyond 2017. And we've taken steps in this coming year in our cost structure to protect our margin and our ability to grow Cable's operating cash flow.

Another priority in 2017 is to launch our wireless product. I would characterize our efforts and approach in the following way. One, we plan to include wireless in our multi-product bundles in a way that is designed to add value to our customers, improve retention and ultimately benefit lifetime customer economics for us. Our offering will give customers access to a world-class wireless network benefiting from our WiFi with the best mobile devices and a simple, transparent experience, all for a great value.

Two, we will be disciplined with our investment and expect to be NPV positive on each incremental customer once we've achieved a limited initial scale. And three, we will be measured in our roll-out, learning and adapting along the way. Mike will provide some additional details later on the call.

At NBCUniversal, we're well-positioned with a range of opportunities ahead of us. The conclusion of recent distribution deals at year-end gives us excellent runway on retrans and affiliate fees.

In addition, the year is off to a great start at Broadcast, where, so far this season, NBC is once again ranked number one in 18-to-49 viewing, but this time has more than a 30% margin over the number two ranked network. This is the biggest lead for any network 17 weeks into the season in the history of Nielsen's People Meter sample.

In Parks, we expect big things from Orlando in 2017, as we bring a third gate to market with our spectacular new water park, Volcano Bay, and launch an impressive Jimmy Fallon attraction, Race Through New York.

In Film, the year-end success continues to benefit us into the first quarter, which helps us start the year on solid footing leading into upcoming releases of our returning top franchises, including Fifty Shades Darker, The Fate of the Furious and Despicable Me 3.

So overall, we're confident and optimistic about the opportunities ahead. We have great momentum in our businesses, and we'll stay true to our formula, embracing ways to be entrepreneurial and invest prudently for growth, looking for smart investments while also returning a significant amount of cash to shareholders.

Mike, over to you.

Michael J. Cavanagh {BIO 3375974 <GO>}

Thanks, Brian, and good morning, everybody. I'm starting on slide 5 for those following presentation online. I'm going to go into greater detail on the slides to come, but let me give a quick summary of the consolidated numbers.

Our fourth quarter results reflect consistent execution and broad-based strength across our businesses. Consolidated revenue increased 9.2% and operating cash flow grew 7.8% for the fourth quarter, reflecting solid growth in our operating businesses.

Earnings per share was $0.95, a 20.3% increase compared to a year ago. On an adjusted basis, EPS increased 9.9% to $0.89.

Free cash flow during the quarter increased 64.2% to $2.6 billion, primarily driven by growth in operating cash flow and improvements in working capital. For the full year, we generated $8.2 billion of free cash flow, a decline of 8.2%. This decline was mainly driven by higher working capital and capital expenditures.

So now let's start with Cable Communications on slide 6. Cable Communications delivered strong fourth quarter results. Revenue increased 7.1% to $12.8 billion, as we added 258,000 customer relationships and reduced churn across all products. In fact, we have improved churn in Video and high-speed data for 12 consecutive quarters, which we believe is driven by the positive benefits of the X1 platform, our best-in-class high-speed data product and the meaningful strides we have made in improving customer service.

High-Speed Internet continues to be the largest contributor to overall Cable revenue growth. Revenue increased 9% to $3.5 billion in the quarter, reflecting an increase in our customer base and rate adjustments. Our customer momentum continued as we added a combined 385,000 net residential and business high speed data customers in the quarter and added 1.4 million net customers during the full year, our best full year results in nine years. Our high-speed data penetration is 43.8%, up from 41.9% a year ago, as customers continue to respond to our product differentiation.

Through consistent investment and innovation, we offer the best broadband product on the market. We double the capacity of our network every 18 to 24 months, have increased Internet speed 17 times in the past 16 years, and now over 50% of our residential customers have speeds of 100 megabits per second or higher.

Coupled with the best in-home WiFi experience, we believe this greatly increases our customer value proposition and competitive differentiation. Looking ahead in 2017 and beyond, we think there's a lot of runway to continue to grow high-speed data subscribers.

Video revenue increased 4.3% to $5.6 billion in the quarter, primarily due to rate adjustments and customers subscribing to additional services. In terms of volume, we added an impressive combined 161,000 net Video customers in 2016, compared to a loss of 36,000 customers in 2015. This is the first time in 10 years that we have added Video customers for a full year. We ended the year strong, adding 80,000 net Video customers in the fourth quarter, driven by continued improvements in customer retention, better market segmentation and broader recognition of what we believe is the best video product on the market.

Our X1 platform is a real competitive differentiator, and we have made good progress rolling it out. We deployed X1 to 936,000 net new and existing customers during the quarter, ending the year with 48% of our residential Video customers having X1 compared to 30% a year ago. Even as we have expanded the base of X1 customers, the positive benefits continue with better retention, improved customer satisfaction, and higher Net Promoter Scores for X1 customers. As a result, we will continue our rollout of X1 at a healthy pace, with an expectation that year end 2017 penetration will be in the low 60%s range.

Voice revenue declined by 3% to $873 million in the fourth quarter, as the positive impact of adding a combined 44,000 net customers was offset by a modest decline in ARPU. The strong results in Business Services continued in the fourth quarter. Revenues increased 14.5% to $1.4 billion during the quarter, with the small business segment accounting for over 70% of our revenue and 60% of our growth, driven primarily by the net increase in customers. Revenue for the midsize business segment had a higher growth rate, fueled primarily by additional Ethernet sites as we continue to invest in expanding that business.

Cable Advertising revenue increased 14.9% to $728 million, reflecting higher political revenue related to the elections. Excluding the political contribution, our Cable Advertising revenue decreased 1.9%.

Turning to slide 7, fourth quarter Cable Communications operating cash flow increased 6.4% to $5.2 billion, resulting in a margin of 40.4% compared to 40.6% in the fourth quarter of 2015. The change in margin was driven by higher expenses, primarily related to programming.

Programming expenses grew 12.2% during the quarter, reflecting the timing of contract renewals, while the full year increased 10.1%. The underlying increases continue to be driven by higher retransmission consent fees and higher sports programming costs. For 2017, we expect programming expense growth of approximately 13%, driven by contract renewals that began in the second half of 2016 as well as additional contract renewals beginning in the first quarter. We continue to believe that in the years following 2017, programming expense growth should normalize to historic levels of high single-digit growth.

Non-programming expenses increased 4.8% for the quarter, which is lower than the full year growth of 5.7%. The fourth quarter growth reflects higher expenses to continue the rollout of X1, but these are partially offset by benefits we are beginning to realize from the investments we have made to improve the customer experience over the past several quarters. Notably, customer service expenses declined 2.1% this quarter. We expect the rate of growth for non-programming expenses to trend lower in 2017 compared to 2016, as we continue to benefit from our customer experience initiatives and disciplined cost management.

Our focus on cost controls, along with modest rate adjustments and growth in high margin businesses like high-speed data and Business Services, should allow us to again mostly offset the impact of elevated programming expense growth. As a result, our outlook for 2017 Cable operating margin is that it will be flat to down 50 basis points compared to 40.2% in 2016.

So now, let's move onto NBCUniversal's results. On slide 8, you can see NBCUniversal's revenue increased 13% and operating cash flow increased 14% in the quarter. Adjusting to include the acquisition of Universal Studios Japan in last year's results, pro forma revenue increased 10.5% and operating cash flow increased 7.8%.

Cable Networks revenue increased 4% and operating cash flow increased 2.4% to $916 million, reflecting higher distribution and content licensing and other revenue, partially offset by an increase in programming and production expenses, including higher sports rights costs.

Distribution revenue increased 4.7%, driven by contractual rate increases and contract renewals, partially offset by a slight decline in subscribers at our Cable Networks. Content licensing and other revenue increased 14.6%, due to the timing of content provided under licensing agreements as well as the sale of USA's Falling Water into SVOD. Advertising revenue increased slightly, as higher rates were mostly offset by ratings declines.

Broadcast Television had another strong quarter, with revenue growth of 14% and operating cash flow growth of 21.1%, to $264 million. This increase reflects higher advertising, content licensing and retransmission revenue, partially offset by higher programming and production spending. Advertising revenue growth of 12.4% included our premiere of Thursday Night Football and higher political advertising. Excluding these, advertising increased modestly, as strong pricing from the upfront outpaced ratings declines.

Content licensing increased 20.2%, primarily due to the availability of content provided under licensing agreements. Last, retransmission revenue increased 55% to over $200 million for the quarter, and totaled nearly $850 million for the full year. In 2017, retransmission revenues should reach nearly $1.4 billion, an increase of almost 65% over 2016, as a result of the recent successful renewals of a number of our distribution agreements.

Film revenue increased 12.6% to $1.8 billion and operating cash flow declined 15.3% to $121 million. These results reflect the full quarter of DreamWorks, which we acquired at the end of August. While the strong box office performance of Sing drove a 97% increase in theatrical revenue during the quarter, a tough home entertainment comparison to last year and DreamWorks-related expenses resulted in the 15.3% decline in OCF. For the year, Film generated about $700 million in OCF.

While this is down 43.5%, due to the difficult comparison to the record results that we achieved in 2015, 2016 nonetheless proved to be one of the best years in the history of our film studio. And in 2017, we are excited to have some of our biggest franchises return.

Theme Parks revenue increased 32.1% to $1.3 billion. And operating cash flow increased 41.9% to $640 million in the fourth quarter of 2016. On a pro forma basis for Universal Japan, revenue increased 13.2% and operating cash flow increased 18.4%. These results reflect higher attendance and higher per capita spending, driven by new attractions including The Wizarding World of Harry Potter in Hollywood, King Kong and The Incredible Hulk in Orlando, and the Jurassic Park Coaster in Japan. In addition, the stronger Japanese yen has a positive impact, accounting for about 20% of the overall OCF growth.

Partially offsetting these results were higher costs associated with new attractions, and the impact of having to close our Orlando Park for two days due to Hurricane Matthew. As we look to 2017, we expect our investments in new attractions to continue to drive growth. As Brian mentioned, we are looking forward to Orlando opening a third gate with the Volcano Bay Water Park. In addition, we will be opening a Jimmy Fallon attraction in Orlando, and bringing the successful Despicable Me attraction to Japan.

Let's move to slide 9 now to review our consolidated and segment capital expenditures. Consolidated capital expenditures decreased 2.4% to $2.6 billion in the fourth quarter.

At Cable Communications, capital expenditures increased 1.5% to $2.1 billion for the quarter and increased 7.9% to $7.6 billion for the full year, resulting in capital intensity of 15.2%, which is in line with the plan we outlined at the beginning of the year.

The full year was led by customer premise equipment including X1 and wireless gateways, which remained the largest component of our capital expenditures, though spending declined modestly year-over-year.

We also invested in our network through increased spending in line extensions as we extended our network to more business and residential customers and in scalable infrastructure as we invested to increase our network capacity. These investments enhance our competitive position, allowing us to continue to take advantage of opportunities to grow penetration and market share by delivering the best broadband product to more homes and businesses.

For 2017, spending on CPE is expected to continue to decline, while we increase our investment in network capacity as well as our investment in line extensions to reach more customers. As a result, our outlook is for 2017 capital intensity to remain flat to 2016 at approximately 15%. Longer-term, as spending on CPE continues to decline as X1 scales and shifts to less expensive IP devices, we expect to see a decline in overall capital intensity.

At NBCUniversal, capital expenditures decreased 17.2% to $461 million in the fourth quarter and increased 4.8% to $1.5 billion for the full year. The full year growth was primarily driven by the inclusion of Universal Studios Japan and investments in the Orlando Park. In 2017, NBCUniversal's capital investment plan is expected to increase approximately 10%, reflecting the continued spending in Theme Parks, as these investments are clearly generating strong returns as they drive increased attendance and per capita spending.

Now before finishing on return of capital, let me build on Brian's earlier comments on wireless. In terms of how we'll report on our wireless initiative, we'll report the results of wireless in the Corporate and Other segment. And once the business is launched, we'll provide quarterly reporting on its key financial metrics.

The only guidance we can provide for 2017, since we still haven't launched our offering, is that the OCF of the Corporate and Other segment may see an additional $200 million to $300 million drag over the approximately $900 million of negative OCF in 2016.

Separate from the OCF impact of wireless is the working capital impact of providing handsets. Our approach will be to purchase the phones and collect handset-related payments from our wireless customers over time. While this approach to handset financing will impact the timing of our free cash flow recognition, we wouldn't expect it to impact overall company capital allocation plans. We are excited to launch and learn from our wireless initiative in 2017.

Now, let's finish on slide 10 with our capital allocation plans. To remind everyone, our capital allocation plan is a balance of several important priorities. The first is investing in our businesses to increase the long-term earnings capacity of the company, including our CapEx investment, the deployment of capital to enhance our existing businesses, and exploring growth opportunities. I believe the plan we have for 2017 will continue to demonstrate our prudent and consistent approach to investing in our businesses.

The second aspect of the balance is a healthy and steady return of capital to shareholders. As you can see on the left side of the page, Comcast has a great track record of consistent capital returns. In 2016, we returned $7.6 billion to shareholders, comprised of $2.6 billion in dividends and $5 billion in share repurchases.

For 2017, we are increasing our dividend 15% to $1.26 per share, which reflects our efforts to deliver a prudent dividend payout ratio balanced with a competitive relative yield, consistent with ranges in which the company has operated in the past. We believe we have a strong history in this respect. This is the ninth consecutive annual increase in the dividend. And the compound annual growth rate in our dividend from 2009 to 2016 was 22.2% versus 10.3% for the S&P 500.

In addition to the dividend increase, we expect to buy back $5 billion of stock in 2017, similar to our buyback in 2016. And the last element of balancing our capital return priorities is the imperative to maintain a strong balance sheet. We ended 2016 at 2.2 times leverage, and we continue to be comfortable operating with leverage around this level.

That concludes our summary of the quarter. I hope that everyone now has a good sense for how pleased we are with our fourth quarter and full year 2016 results as well as our momentum as we begin 2017.

Now, I'll turn it back to Jason to lead the Q&A session.

Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Mike. Regina, let's open up the call for Q&A, please.

Q&A

Operator

Thank you. We will now begin the question-and-answer session. Our first question comes from the line of Jessica Reif Cohen with Bank of America. Please go ahead.

Q - Jessica Jean Reif Cohen {BIO 20736441 <GO>}

Thank you. One for Neil and one for Steve, if that's okay; Neil, Brian outlined like several priorities for 2017. And there just seems to be a lot going on in your area. Could you give us color on maybe your top three priorities for the year?

And then for Steve, seven years later, there still seems to be some big buckets of growth opportunity for NBCU. Some of the more obvious ones seem like Telemundo, where your ratings are up pretty dramatically versus your competitor, consumer products and Theme Parks, obviously. Can you talk about some of the areas that provide the biggest upside? And maybe is Cable Networks the biggest risk for the year?

A - Neil Smit {BIO 7323144 <GO>}

Hi, Jessica. This is Neil. I think the top three priorities are: continue to win in Video, rolling out X1 deeper into the base; drive and continue winning in HSD, where we roll out DOCSIS 3.1 and advanced gateways and drive Business Services; continue to rollout hyperbuilds and roll in all three markets, small, medium and enterprise. I think additionally, we're going to continue to focus on customer experience. And we'll roll out the wireless product in the middle of the year.

A - Stephen B. Burke {BIO 1983798 <GO>}

So we've owned NBCUniversal now for almost exactly six years. And during that time, we've had the fastest compounded growth rate of any of the media companies. I still think there's a lot of opportunity, maybe not quite as much opportunity as there was in the early days, but you mentioned a few of the areas. Theme Parks, I think we have a long, long runway. As long as we invest and build more hotel rooms and have creative attractions, we, I think, have a lot of growth ahead of us there. Consumer products you mentioned. We were essentially out of the consumer products business six years ago. And now, that business I think is couple hundred million dollars of OCF and has a long, long runway as we build that out.

Telemundo's a great story, where Telemundo was essentially making no money at all. And it now makes a couple hundred million dollars a year. And, as you mentioned, our ratings would suggest in the future, we should make significantly more than that. But we have another dozen things that we're looking at investing in and trying to optimize and grow. And I think the easiest stuff, obviously, you do first, but I think we still have a lot of opportunity to continue to grow the company.

Q - Jessica Jean Reif Cohen {BIO 20736441 <GO>}

Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Jessica. Next question, please.

Operator

Your next question comes from the line of Ben Swinburne with Morgan Stanley. Please go ahead.

Q - Benjamin Daniel Swinburne {BIO 5489854 <GO>}

Thank you. I want to ask about X1 and about free cash flow. So on X1, either for Brian or Neil or both of you, when you look at the X1 deployment in 2017, and particularly the impact you've had recently deploying that product, how are the returns looking versus what you saw going back to the beginning of the deployment? I'm wondering if you're seeing the same kind of churn, ARPU lift, et cetera. And I know the product has obviously evolved. You mentioned Netflix. Just curious how you think about that going forward versus what we've seen in the past and if the low 60%s is sort of the maturation point for that product, in your mind?

And then on free cash flow for Mike, free cash flow in 2016, I think, was down year-on-year. It's a big working capital drag. I guess it's mostly NBC related, but you mentioned the wireless drag. Any help with free cash flow in 2017? And maybe help us think about how you prioritize free cash flow versus earnings from a financial management perspective of the company?

A - Neil Smit {BIO 7323144 <GO>}

Ben, concerning X1, we continue to see very positive results consistent with early in the launch. We were at 48% penetration, going to low 60%s next year. I think ultimately, it could be a 75% to 80% penetration. DVR uptake is three times the legacy. Pay-per-view is two times. We get more additional outlets. We get more VOD viewing. So it continues to be an improved impact on retention and higher ARPU. So I think we're going to continue to drive it into the base, and it's continued to perform as well or better than expectations.

A - Brian L. Roberts {BIO 1415772 <GO>}

Before Mike jumps in, let me just add to that. If you look at our Video ARPU and combine that with the fact that we had the best Video year in 10 years, and half our base now is X1, it's pretty exciting to get the other half, however far it can ultimately go with that product. The product itself didn't remain static. The Netflix integration, just to name one, was a great achievement during the year. What we did during the Olympics was really special and, of course, voice, the amount of utterances.

The last thing is the team is really focused on reliability of X1, hardening the system. And I've seen a number of charts of sort of customers who've had it now for a couple years and what their churn and their reliability and their usage – and every way you study this thing, it looks like a fantastic product, game-changing product, and I think the results continue to encourage us to keep going.

A - Michael J. Cavanagh {BIO 3375974 <GO>}

Ben, it's Mike. So on free cash flow in 2016, the decline was for the reasons we talked about on this call a year ago. It was a year where we had, in particular, a drag on working capital given the Olympics. But as you look at 2017, based on everything we've said earlier on this call, the operating results and momentum in both of the operating businesses, as well as a plan for good investments in the businesses, net of all that is we expect to grow free cash flow in 2017.

Beyond that, I would say it's our expectation to be growing free cash flow over the long term, though one year to the next, we'll have some variability based upon some of the investments and, obviously, some of the business cycles, but we do focus on it. It's a big, important factor as we're running the company. It's not the only thing we look at, though. So hopefully, that covers it for you.

Q - Benjamin Daniel Swinburne {BIO 5489854 <GO>}

Thank you very much.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Ben. Next question, please.

Operator

Your next question comes from the line of Craig Moffett with MoffettNathanson. Please go ahead.

Q - Craig Eder Moffett {BIO 5987555 <GO>}

Hi. Thank you. Brian, I wonder if you could talk a little bit more about your wireless entry this year. And in particular, sort of how should we think about the MVNO agreement with Verizon? Should we think of the MVNO agreement as sort of an end state? That is, where – something that you think you can actually make a real sustainable long-term business or more as a stepping stone to a longer-term strategy, where you think of the MVNO really as sort of the market entry strategy instead?

A - Brian L. Roberts {BIO 1415772 <GO>}

Well, I think what we've said was pretty clear. But just to go a little deeper into that now is I believe that we'll find out. But we're hoping that it's an end state strategy and that it's sustainable. And the goal of the business is to have better bundling with some of our customers who want to save some of their bill and get a world-class product and take a bundle and have lower churn. And if you can achieve that, we'll see. The economics really work. And that's the goal. And there's only one way to find out and it's to get started. And we're going to take it very carefully. And Neil's doing a great job getting us organized.

Q - Craig Eder Moffett {BIO 5987555 <GO>}

So if I could ask a follow up then, Brian, is the Verizon relationship then, do you think of it as a network supplier or is it deeper than that? Is it really a partner in the wireless business?

A - Brian L. Roberts {BIO 1415772 <GO>}

I'm going to stop there and say stay tuned. And we'll clarify things. But we're putting together – we have a good relationship, we believe, and we're excited to get it launched. We'll learn a lot as we go. One example is the way X1 worked. We crawled, walked, ran, and we knew for sure that we had a really special thing before we really hit the pedal. And that allowed us to answer the previous question with a lot of confidence as we have a world-class product. And we think we have the piece parts, but we'll find out together and we'll be very transparent as we go.

Q - Craig Eder Moffett {BIO 5987555 <GO>}

That's great. Thanks, Brian.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Craig. Next question, please.

Operator

Your next question comes from the line of Jason Bazinet with Citi. Please go ahead.

Q - Jason Boisvert Bazinet {BIO 4013756 <GO>}

Just a question for Mr. Smit. I think there's still some confusion, at least among our clients, about whether coax or fiber can support 5G. And so can you just elaborate sort of on your view of that? And in particular, any sort of color on where you are in terms of homes passed per node. Are we sort of at the 250 level, or is it lower than that? Any sort of color would be helpful. Thanks.

A - Neil Smit {BIO 7323144 <GO>}

Well, hi, Jason. I think that 5G is an exciting evolution in the business. It has some characteristics that require densification of antennas. It propagates over short distances. It doesn't pass through physical objects very well. We're doing some testing right now. We think that it's going need economical space, power and backhaul. We have, call it, 150,000 miles of fiber across 650,000 miles of total plant. And we think that we're well-positioned to participate in the 5G rollout, no matter how it happens, as a result of having all those assets in place already.

Concerning the usage, I mean, our HSD usage went from a median of 88 gigabits per month in Q4, and that's up 55% from 57 gigabits during the same period of 2015. And if you look at cellular data usage, it's about 3 gigabits per month average. So there's a lot of capacity in the wired network. We feel comfortable with our position in participating in the overall 5G roll-out.

Q - Jason Boisvert Bazinet {BIO 4013756 <GO>}

Is it fair to say that you can't support 5G on coax, but you may be able to do it on fiber? Is that too simple of a distillation?

A - Neil Smit {BIO 7323144 <GO>}

I think that's a simple distillation. We're testing and we'll continue to learn. It's early in the roll-out.

Q - Jason Boisvert Bazinet {BIO 4013756 <GO>}

Okay. Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Jason. Next question, please.

Operator

Your next question comes from the line of Phil Cusick with JPMorgan. Please go ahead.

Q - Philip A. Cusick {BIO 5507514 <GO>}

Thanks, Jason. One for Neil on video; it's great to see growing video subs. Is it still your goal to grow video at this or a faster pace, given the expansion of X1 and better customer experience? And how do you see that potentially offset by continued industry decline, driven by cord-cutting and MVPDs? And quickly a follow up on wireless; Brian, it sounds like we should be looking for a few cities to start maybe at mid-year and slow expansion from there. Is that fair?

A - Neil Smit {BIO 7323144 <GO>}

We continue to see opportunity in Video and we'll continue to focus on growth of the business and gaining market share. We've seen competition before. We've continued to adjust and compete. We think X1 is a great platform and will continue to drive Video results. Brian?

A - Brian L. Roberts {BIO 1415772 <GO>}

I'm not going to add any color to our statement that we're going to launch something by the first half of the year, and we'll have more to say and we'll let you know when we're ready. We're not ready today to answer that.

Q - Philip A. Cusick {BIO 5507514 <GO>}

Got it. Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Great. Thanks, Phil. Next question, please.

Operator

Your next question comes from the line of John Hodulik with UBS. Please go ahead.

Q - John Christopher Hodulik {BIO 1540944 <GO>}

Hey, thanks. Maybe just one more try on the wireless side, maybe for Mike. Any chance you could quantify or maybe bookend the working capital drag you expect from the wireless launch? And then maybe for Neil, shifting over to business; business, the growth is slowing a little bit. It seems to be sort of an emerging trend in the, you know, across the industry. Can you remind us where your market shares are both in the small and medium-sized business market, maybe the investment strategy, and whether you expect to see that deceleration sort of level off as we look out into 2017?

A - Michael J. Cavanagh {BIO 3375974 <GO>}

So it's Mike. So just on handsets, I made the point earlier that the whole thing in wireless is going be success-based, so I would wrap the comments on free cash flow for 2017 in what I said earlier. We expect to grow inclusive of everything and more to come later when we actually come back to talk about the wireless launch.

Q - John Christopher Hodulik {BIO 1540944 <GO>}

Got it.

A - Neil Smit {BIO 7323144 <GO>}

In Business Services, we expect to continue to grow, generate double-digit revenue growth for the next several years by capturing share. It's a $5.5 billion revenue business. We've been growing about three-quarters of a billion dollars per year over the last couple years. We have about 20% share in small, 15% share in medium, and the opportunity in enterprise, we believe, is a $13 billion to $15 billion opportunity in our markets, so we see strong growth across all three segments.

Q - John Christopher Hodulik {BIO 1540944 <GO>}

Okay. Thanks.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, John. Next question, please.

Operator

Your next question comes from the line of Vijay Jayant with Evercore ISI. Please go ahead.

Q - Vijay Jayant {BIO 1526830 <GO>}

Thanks. Just a broader question, first, for Brian with the prospect of Trump-related tax reform and a deregulated FCC philosophy, can you talk about how if those sort of worked out based on current thinking, what would you do differently in terms of investment and return on capital? And a quick one for Neil; obviously, the Netflix carriage on the X1 platform, you guys talked about being very successful. Are these platforms willing to pay to be authenticated on these platforms? Is that a real opportunity as you add more applications on? Thanks so much.

A - Brian L. Roberts {BIO 1415772 <GO>}

Okay. Well, thanks for the question. I think regulatory certainty for investors is the same as it is for management. It helps you have the confidence to make long-term plans. And the kind of discussion we've been having this morning, whether it's fiber or other investments in in-home equipment, and what your business opportunities are, the more uncertainty, the less encouraging it is to want to invest. So we're encouraged by the prospect of rules that we believe will encourage that investment, stimulate investment, whether that's tax decreases or revisiting the authority of the government to go to places that they said they weren't going to, but legally they could go to in the Open Internet Order with Title II.

So we're looking forward to working with the new administration and the new regulatory leaders to try to frame something that's good for consumers, and it gives a stable platform that we can invest in and I think should allow us to accelerate both business opportunities and if there are things such as tax return, then revisit it where all that opportunity lies and how much gets returned to shareholders and invested in new opportunities. So we're encouraged and stay tuned.

A - Neil Smit {BIO 7323144 <GO>}

Concerning the Netflix integration, I think it's a tribute to both the flexibility of the platform that we were able to integrate it so smoothly, and a tribute to Tony Werner and the Technology team and the speed with which they got it done. VOD viewing for the fourth quarter was up overall about 18%. And we want to offer more and complementary content to make the viewing experiences as rich and easy to access as possible. So we'll continue to seek other partners and integrate them into the overall experience.

Q - Vijay Jayant {BIO 1526830 <GO>}

Great. Thank you.

A - Neil Smit {BIO 7323144 <GO>}

Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Vijay. Next question, please.

Operator

Your next question comes from the line of Marci Ryvicker with Wells Fargo. Please go ahead.

Q - Marci L. Ryvicker {BIO 6183203 <GO>}

Thanks. I have two. The first one's for Steve. Assuming that, at some point, there is an increase in the national cap or the UHF discount is reinstated, what is your appetite to acquire stations? And then, my second question is for Mike and your view on capital returns. Just curious, how flexible is this? We are going to have the auction over. There's the potential for tax reform. So is this something that you will revisit from time-to-time or is your view on capital returns that it is a one-time thought process, and you'll revisit it again next year? Thanks.

A - Stephen B. Burke {BIO 1983798 <GO>}

So we like the broadcast business. We think we're doing well in it. And recently, took an affiliation back from an affiliate in Boston and launched a station there, which we now own as of January 1 at essentially no cost. We had some start-up costs, but that, to me, was a wonderful way to increase our footprint. I don't think there's a necessity to increase our footprint, but I think if the caps get changed, we would certainly look at it and do what's right for the company.

A - Michael J. Cavanagh {BIO 3375974 <GO>}

And, Marci, it's Mike. On capital return, it is an annual exercise. We take it seriously this time of the year and give what we think is the right guidance for what we'll do in the course of the year, factoring in everything we have a point of view on, obviously. So that would include everything, but, in this case, corporate tax reform. Corporate tax reform, we're in a wait and see mode. We're big supporters of the idea of corporate tax reform. We think it would be good for the U.S. economy, but none of our capital plans, none of what I've described today are counting on any particular changes in corporate tax. When all that is done, we'll do a holistic review of what it all means and come back and report. That may well be in this call next year. But if it happens really early in the year, we'll see.

Q - Marci L. Ryvicker {BIO 6183203 <GO>}

Got it. Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Marci. Next question, please.

Operator

Your next question comes from the line of Bryan Kraft with Deutsche Bank. Please go ahead.

Q - Bryan Kraft {BIO 20667157 <GO>}

Hi. Good morning. I wanted to ask a question on cable advertising and also one on the theme parks, if that's okay. First on cable advertising; excluding political, it's been pretty soft for a few quarters now. Is that something you view as cyclical or secular? And if it is secular, do you have any view on when you think revenue growth from advanced advertising will be large enough to offset it and bring you back to a growth trajectory there? And then, on the theme parks, I was just curious, Steve, what are the trends you're seeing with booking and reservations? I know it's been quiet on the Zika front lately, but are you seeing any impact from concerns re-emerging as the weather warms up this spring? Thanks.

A - Neil Smit {BIO 7323144 <GO>}

This is Neil. On cable advertising, we have seen the core a little softer than in the past. Auto, in particular, is a little bit soft, but I think it may just be cyclical. And we are making up some of the difference in advanced advertising. We're seeing strong growth there. And I think we'll continue to build upon that capability going forward.

A - Stephen B. Burke {BIO 1983798 <GO>}

So just to add to what Neil said about local cable advertising, the national advertising market is very strong. And it's been very strong now for a while. We had such a good upfront last year. One would have assumed that scatter might slow down. That often happens. That has not happened this time. And all of the indications, options, cancellations, the type of shows people want to get into, suggest to me that we have a good shot of having another very strong upfront nationally.

In terms of theme parks, all the bookings and advance indications for Florida and for California remain strong, quite strong. I think we're going to have a very big year in Orlando. We're opening, I believe, the world's best water park in the spring, and an attraction based on The Tonight Show, and that'll get a lot of publicity and a lot of attention. And hotels are 90% occupancy. Bookings look great and we got great new attractions. So my bet is that we're going to have a very strong year in both Orlando and in California. And then, Japan, we own 51% of Osaka. Japan has a Despicable Me attraction going in, and their attendance trends are good. So I think all green lights, as far as I can see, in the theme park business.

Q - Bryan Kraft {BIO 20667157 <GO>}

Great. Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Bryan. Next question, please.

Operator

Your next question comes from the line of Anthony DiClemente with Instinet. Please go ahead.

Q - Anthony DiClemente, CFA

Thanks. I have for Mike and one for Neil. Mike, on the 2017 programming expense uplift, the 13%, just wondering on a net basis what that's going to imply for Cable OCF growth in 2017? So we're getting to around mid-single-digits and I assume it could decelerate. Can you just talk about that? And then, should it reaccelerate again in 2018 as the programming expense growth moderates, as you describe? And then maybe for Neil, back to the topic of set-top box integration, you talked about Netflix. Before year end, you signed a deal to integrate Sling into the X1 platform, so just wondering about that decision. Could you just talk about the thought process there? And does that one create any risk from a competitive standpoint over time? Thank you for the question.

A - Michael J. Cavanagh {BIO 3375974 <GO>}

Thanks, Anthony, for the question. It's Mike. So on the first point, I'll just maybe restate some of what we said earlier which is that, yes, programming costs are high in 2017 for the reasons we described, which is big renewals happening in the second half of 2016 and early – with effective the beginning of 2017 and that rate comes down in the years that follow 2017 to something that looks more normal. I'd say the overarching and important point is all the work that Neil and team have been doing on non-programming costs.

So you saw it in 2016, where when programming costs were also higher than the normal long-term rates, great work to protect the margin of the overall business. And the guidance we gave for margin is that it'll be flat again to down 50 basis points in 2017. So, obviously, all the growth and initiatives that Neil has working to drive the top line will push through that margin. And I'll leave it to you to kind of model that out.

A - Neil Smit {BIO 7323144 <GO>}

Concerning the Sling integration, we really were focused on the multicultural content that they had. It's an important segment for us to target, and we think they have great content and will be a good partner to integrate.

Q - Anthony DiClemente, CFA

Okay. Thank you.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Thank you, Anthony. Regina, we'll take one last question, please.

Operator

Our final question will come from the line of Brett Feldman with Goldman Sachs. Please go ahead.

Q - Brett Feldman {BIO 3825792 <GO>}

Thanks. I want to ask about the customer service expenses. They were actually down year-over-year in the quarter. You mentioned you had fewer calls into customer service as a driver. And this is an area where you've just invested so much over the last few years. I'm wondering if what we saw is potentially an inflection point, meaning you're not simply benefiting through lower churn, but you're actually getting better operating leverage now through the P&L because of the sum total of the investments that you've made there.

A - Brian L. Roberts {BIO 1415772 <GO>}

I think that's a good assessment. We've made investments on taking noise out of the system, reducing the calls, focusing the truck rolls, getting it right the first time, being on time and all those things, the move experience, the onboarding experience, we're very focused on. And the teams have done a great job, led by Dave Watson, in driving, as I said, some of the noise out of the system. And I think, ultimately, this will reflect itself in better profitability as we take unnecessary costs out of the system, and we retain customers for a longer period as a result.

Q - Brett Feldman {BIO 3825792 <GO>}

And is this one of the key line items that supports your outlook for less upward pressure on non-programming expenses this year?

A - Brian L. Roberts {BIO 1415772 <GO>}

Yes, it is.

Q - Brett Feldman {BIO 3825792 <GO>}

Great. Thanks for taking the question.

A - Jason S. Armstrong {BIO 6732609 <GO>}

Great. Well, thank you, Brett, and thank you, everyone, for joining us this morning. We'll wrap it up there. Regina, back to you.

Operator

There will be a replay available of today's call starting at 12:00 p.m. Eastern Time. It will run through Thursday, February 2, at midnight Eastern Time. The dial in number is 855-859-2056 and the conference ID number is 40819623. A recording of the conference call will also be available on the company's website beginning at 12:30 p.m. Eastern Time today. This concludes today's teleconference. Thank you for joining. You may all disconnect.
