Q4 2018 Earnings Call

Company Participants

- Christopher L. Winfrey, Chief Financial Officer
- Stefan Anninger, Senior Vice President, Investor Relations
- Thomas M. Rutledge, Chairman & Chief Executive Officer

Other Participants

- Amy Yong, Analyst
- Benjamin Daniel Swinburne, Analyst
- Douglas Mitchelson, Analyst
- Jessica Reif Ehrlich, Analyst
- John C. Hodulik, Analyst
- Jonathan Chaplin, Analyst
- Philip A. Cusick, Analyst
- Vijay Jayant, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Michelle, and I will be your conference operator today. At this time, I would like to welcome everyone to the Charter's Fourth Quarter 2018 Investor Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

I would now like to turn the call over to Stefan Anninger. Please go ahead.

Stefan Anninger {BIO 15867691 <GO>}

Good morning, and welcome to Charter's fourth quarter 2018 investor call. The presentation that accompanies this call can be found on our website ir.charter.com under the Financial Information section.

Before we proceed, I would like to remind you that there are a number of risk factors and other cautionary statements contained in our SEC filings including our most recent 10-K filed this morning. We will not review those risk factors and other cautionary statements on this call. However, we encourage you to read them carefully. Various remarks that we make on this call concerning expectations, predictions, plans and prospects constitute forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ from historical or anticipated results.

Any forward-looking statements reflect management's current view only and Charter undertakes no obligation to revise or update such statements or to make additional forward-looking statements in the future.

During the course of today's call, we will be referring to non-GAAP measures as defined and reconciled in our earnings materials. These non-GAAP measures as defined by Charter may not be comparable to measures with similar titles used by other companies. Please also note that all growth rates noted on this call and in the presentation are calculated on a year-over-year basis unless otherwise specified.

Joining me on today's call are Tom Rutledge, Chairman and CEO; and Chris Winfrey, our CFO. With that, I'll turn the call over to Tom.

Thomas M. Rutledge {BIO 1818216 <GO>}

Thank you, Stefan. We performed well in 2018, while simultaneously completing the most customer impacting phase of our integration. For the full year, we grew our total Internet customer base by 1.3 million customers, or 5.3%. We grew cable revenue by 4.7% in 2018 and cable adjusted EBITDA by 6.5%. With our integration now nearly complete, our goal is to accelerate customer relationship and cash flow growth going forward.

Following our transactions in May of 2016, we put three very large companies together in order to create a new company with a larger and more concentrated footprint, giving us the scale to innovate and grow faster. We're beginning to benefit from that strategy in all the ways we expected. When we started the process of pursuing additional scale in 2013, we knew that to fully benefit from any acquisitions, we would need to create a single operating entity with a unified product, marketing, technology and service infrastructure. We spent over two-and-a-half years doing that. Slide 4 of today's presentation reflects the progress against the integration plan we first showed in 2016 and the earlier-than-expected launches of DOCSIS 3.1 1-Gig service and Spectrum Mobile.

While our integration and network upgrades have excellent long-term benefits, they've been disruptive to our customers, our ability to execute and counter to our long-term operating strategy of reducing service interactions as planned. That processes though is now essentially complete. We still have some work to do, but virtually all of the customer-facing initiatives related to our integration are now behind us. We've migrated 70% of our acquired residential customers to Spectrum pricing and packaging. Our all-digital initiative is now finished. We've completed the upgrade to DOCSIS 3.1 and the launch of our Gigabit speed offering across our entire residential and business footprint.

Our service infrastructure is national, specialized and consistent. Our call centers and service platforms will be fully virtualized across the company by year-end and our field operation and customer care insourcing are also nearly complete. By the end of 2019, we expect to have completed the very last pieces of our integration. But as I said, most of this year's integration activity is non-customer facing in nature. With our biggest integration initiatives behind us, we're now in a position to drive long-term sustainable customer relationship growth, EBITDA growth, and significantly lower capital intensity driving accelerating free cash flow growth.

As we look forward through 2019, we remain focused on a number of key strategic priorities, including driving higher sales volumes. We made some key changes to our Double and Triple Play packaging in September, including the way we sell landline voice and including Spectrum Mobile in every sales opportunity. Those changes required that we retrain our sales force personnel in all sales channels. That process took through October to take hold and our sales effectiveness will continue to improve. Our fourth quarter results demonstrate that churn continues to show meaningful improvements as planned.

Spectrum Mobile is ramping up. We added over 110,000 mobile lines in the fourth quarter and we're seeing a growing percentage of our new cable sales taking mobile service. We're also upselling mobile service to existing cable customers. Over the longer term, we expect consumer savings from our mobile offering to drive incremental cable sales as we build brand and product awareness for our Spectrum Mobile service and become a more powerful retention tool.

In December, we began the process of allowing customers to transfer their existing handsets to Spectrum Mobile from other service providers at some of our stores. Over the coming months, we'll expand the Bring Your Own Device program to include a broader set of devices and to allow customers to do Bring Your Own Device process themselves without having to visit us in a store. Full Bring Your Own Device availability will expand our mobile market opportunity substantially.

In 2019, we are also well-positioned to reduce service transactions. With the vast majority of our integration behind us, we expect to see a meaningful reduction in network activity, CPE swaps, service calls and truck rolls. Service activity should also decline as our better product and pricing and services across a larger base improves. And as we begin to benefit from enhanced online self-service, greater levels of self installs, so in 2019, the lowered level of activity will raise customer satisfaction, reduce churn and extend customer lifetimes.

Finally, 2019 is the year we'll see a significant reduction in capital intensity. Our goal at the beginning of this process was to put our combined assets in a position to operate as a single entity and to grow faster over the long-term as quickly as possible. As a result, we stepped up capital spending in the short-term. That higher spending is now behind us and cable capital intensity will fall significantly in 2019 as planned, but also beyond 2019 as CPE spend per home declines, consumers increasingly install their own services, the reliability of our plant improves and our network becomes increasingly cloud-based and IP-driven, all on higher expected revenue, while we continue to appropriately invest in our products and in our network.

Already in 2019, I expect the business and cash flow performance of our cable business will further demonstrate the superiority of our networks and our assets, the returns of our recent investment and the long-term benefits of our consumer-focused operating strategy on a larger set of assets.

I'll turn the call over to Chris Winfrey.

Christopher L. Winfrey {BIO 16326284 <GO>}

Thanks, Tom. A couple of administrative items before covering our results; like last quarter, the prospective adoption of the new revenue recognition standard lowered our EBITDA in the fourth quarter by about $7 million as compared to last year. In 2019, there should be less impact year-over-year and we don't expect to continue to highlight the amount. And as it relates to Hurricane Michael and Florence and the wildfires in California, we did have some recovery and rebuild cost in the quarter, but they were relatively small. And since we had storms in last year's fourth quarter, the negative impact to this quarter's EBITDA and CapEx on a year-over-year basis was minimal.

Now turning to our results, total residential and SMB customer relationships grew by 248,000 in the fourth quarter and 942,000 over the last 12 months. Including residential and SMB, Internet grew by 329,000 in the quarter. Video declined by 22,000 and voice declined by 56,000. Over 70% of our acquired residential customers were in Spectrum pricing and packaging at the end of the fourth quarter. And similar to what we saw at Legacy Charter, pricing and packaging migration transactions are slowing, which together with the completion of network upgrades last year means that in 2019, we'll see lower CPE spending and meaningful churn benefits.

In residential Internet, we added a total of 289,000 customers versus 263,000 in the fourth quarter of last year. Over the last 12 months, we've grown our total residential Internet customer base by 1.1 million customers or 4.9%. And we now offer Gigabit service to nearly 100% of our footprint using DOCSIS 3.1.

Over the last year, our residential video customers declined by 1.8%. Sales of our Stream and Choice packages, which are primarily targeted Internet-only, has continued to do well. Spectrum Guide is being deployed to the vast majority of new video connects, providing a better overall video experience. And our video product is available via the Spectrum TV App on a variety of platforms, including Android, Kindle Fire, Roku, Xbox, Samsung Smart TV and computers. We also recently launched our Spectrum TV App on Apple TV with a zero sign-on feature for customers with Spectrum Internet.

In voice, we lost 83,000 residential voice customers in the quarter versus a gain of 23,000 last year, driven by lower triple play selling mix. As Tom mentioned, we changed our voice pricing in mid-September to address wireline voice sell-in, retention at roll-off and the launch of mobile. At acquisition, voice is now $9.99 with no change to that price when a customer rolls off a bundle promotion. With wireline voice as a $9.99 value-added service going forward, mobile is now positioned to be the triple play value driver for connectivity sales, similar to what wireline voice did for cable over the last decade. These are meaningful changes to a large selling machine, but the transition went well in the fourth quarter.

Turning to mobile, we added 113,000 mobile lines in the quarter with a healthy mix of both Unlimited and By the Gig lines. As of December, we had 134,000 lines. As we add new features and functionality including Bring Your Own Device capabilities, we expand our marketable population, as Tom mentioned. Over the last year, we grew total residential customers by 771,000 or 3%. Residential revenue per customer relationship grew by 0.9% year-over-year, given the lower rate of SPP migration and promotional campaign roll-off and rate adjustments. And we did grow subs in voice and video taxes in both revenue and expense with no impact to EBITDA in the past or now. Those ARPU benefits were partly offset by a higher mix of Internet-only customers.

Slide 7 shows our cable customer growth combined with our ARPU growth resulted in year-over-year residential revenue growth of 3.9%. Keep in mind that our cable ARPU does not reflect any mobile revenue.

Turning to commercial, total SMB and enterprise revenue combined grew by 4.5% in the fourth quarter. SMB revenue grew by 3.6% faster than last quarter as the revenue growth impact of re-pricing our SMB products in Legacy TWC and Bright House have slowed. We've grown SMB customer relationships by over 10% in the last year. And in 2019, we expect a lower level of SMB ARPU decline from the re-pricing.

Enterprise revenue was up by 5.7%. Excluding cell backhaul, Navisite and some one-time fees, which were a benefit this quarter, enterprise grew by 6% with 13% PSU growth year-over-year. Our enterprise group is at an earlier stage of a pricing impact due to transition, but it's very similar to what we have done in our larger SMB and residential businesses over the last two years. The process of moving customers to more competitive pricing pressures enterprise ARPU in the near-term, but ultimately, the revenue growth will follow the unit growth as it's beginning to happen in SMB. We remain very confident in the strategy in our long-term growth opportunity in enterprise.

Fourth quarter advertising revenue grew by 34% year-over-year and political advertising accounted for all of that growth as it also utilizes traditional inventory. Mobile revenue totaled $89 million with about $80 million of that revenue being device revenue. As a reminder, under equipment installment plans or EIP, all future device installment payments are recognized as revenue on the connect date, hence the mobile working capital usage during the growth phase, which we've highlighted. In total, consolidated fourth quarter revenue was up 5.9% year-over-year with cable revenue growth of 5.1% or 3.9% when excluding advertising.

So, moving to operating expenses on slide 8. In the fourth quarter, total operating expenses grew by $446 million or 6.7% year-over-year. Excluding mobile, operating expenses increased by 3.6%. Programming increased 5.5% year-over-year and a mid-single-digit growth rate is probably a good baseline for 2019 programming cost growth. Regulatory, connectivity and produced content grew by 11.8% driven by our adoption of the new revenue recognition standard on January 1, 2018, which re-classed some expenses to this line in the quarter as well as the voice and video tax and fee gross up that I mentioned earlier.

And finally, content costs were up given more Lakers games in the fourth quarter of 2018 versus the fourth quarter of 2017. Cost to service customers declined by 0.8% year-over-year compared to 3.5% customer relationship growth. And even excluding some bad debt improvement year-over-year, cost to service customers was flat year-over-year. We are essentially lowering our per relationship service cost through changes in business practices and continue to see productivity benefits from insourcing investments.

Cable marketing expenses declined by 2.3% year-over-year and other cable expenses were up 7% year-over-year, driven by higher ad sales cost for political, IT cost from ongoing integration, property tax and insurance and costs related to the launch of our Spectrum News 1 channel in Los Angeles. Mobile expenses totaled $211 million, and was comprised of device cost tied to the device revenue I mentioned, market launch costs and operating expenses to stand up and operate the business, including our own personnel and overhead costs and our portion of the JV with Comcast.

Adjusted cable EBITDA grew by 7.6% in the fourth quarter. And when including the mobile EBITDA loss of $122 million, total adjusted EBITDA grew by 4.6%. As we look to 2019, annualizing our fourth quarter 2018 mobile EBITDA loss is a good starting place for estimating our 2019 mobile EBITDA losses. That generalization assumes a material acceleration in mobile line growth which drives high acquisition cost as well as ongoing start-up cost. As mobile lines and revenue scale relative to the fixed operating cost and variable acquisition cost, we continue to expect mobile will be a positive EBITDA and cash flow business on a stand-alone basis without accounting for the planned benefits to cable.

Turning to net income on slide 9, we generated $296 million of net income attributable to Charter's shareholders in the fourth quarter versus $9.6 billion last year. The year-over-year decline was primarily driven by last year's GAAP tax benefit given the federal tax reform, higher interest expense, and pension, derivative and other non-cash adjustments in this year's fourth quarter. That was partly offset by higher adjusted EBITDA and lower depreciation and amortization expense.

Turning to slide 10 on CapEx, capital expenditures totaled $2.4 billion in the fourth quarter, about $150 million lower than last year. The decline was primarily driven by lower CPE with less SPP migration and as we finished all-digital. We also had lower scalable infrastructure and support capital spend, given more consistent timing of in-year spend this year versus last, as well as the completion of various integration projects. That was partly offset by higher spend on line extensions as we continue to build out and fulfill our merger conditions. We spent $106 million on mobile-related CapEx this quarter, driven by software, some of which is related to our JV with Comcast and on upgrading our retail footprint for mobile. Most of the mobile spend is reflected in support capital.

Following what I mentioned earlier, using the Q4 mobile CapEx run rate is a simple way to think about 2019 also works. We expect mobile CapEx will decline following the upgrade of our retail footprint. For the full year 2018, we spent $8.9 billion in cable CapEx or 20.4% of cable revenue, down from 20.9% in 2017, consistent with our previous expectations. As we look to 2019, Tom mentioned cable CapEx will be down meaningfully in absolute dollar terms and in terms of capital intensity.

We don't generally provide guidance, but with a significant decline in 2019 capital spend, I will tell you our internal plan calls for roughly $7 billion of total cable CapEx in 2019, down from $8.9 billion in 2018 for all the reasons we've said. Within that number, there's still significant product and network development and some integration capital including both software development and real estate improvements, which we treat as CapEx. As usual, if we find new high ROI projects during the course of the year or that accelerated spend on existing projects will drive faster growth, we would continue to do so.

Slide 11 shows we generated $885 million of consolidated free cash flow this quarter, including about $300 million of investment in mobile. Excluding mobile, we generated approximately $1.2 billion of cable free cash flow, roughly the same as last year's fourth quarter. While this quarter we did have higher adjusted EBITDA and lower cable CapEx year-over-year, those were almost entirely offset by a lower cash flow benefit from working capital year-over-year. Recall that we spent a significant amount of capital in and linked within the fourth quarter of 2017. So, we had a very large working capital benefit nearly $700 million within the fourth quarter of 2017.

Excluding the year-over-year working capital impacts, cable free cash flow was up by over $400 million year-over-year in the fourth quarter. For the full year 2019, I expect another year of working capital related reduction to cash flow as we continue to add mobile customers, which drives handset-related working capital needs, we'll continue to separate that, and as cable CapEx falls meaningfully already in the first quarter in 2019, which means we'll see an immediate and material full year step down in our cable CapEx payables balance, which could make our first quarter 2019 cable working capital look similar to the first quarter of 2018.

The drivers for both of these working capital impacts are logical. And while over the longer term it's a question of timing, both drivers will have outsized quarterly and full year impacts.

We finished the quarter with $72 billion in debt principal, our run rate annualized cash interest at year-end was $3.9 billion whereas our P&L interest expense in the quarter suggests a $3.6 billion annual run rate. That difference is primarily due to purchase accounting. As of the end of the third quarter, our net debt to last 12 months adjusted EBITDA was 4.45 times at the high end of our target leverage range of 4 to 4.5 times. We intend to stay at or below 4.5 times leverage and we include the upfront investment in mobile to be more conservative than looking at cable-only leverage, which stands at 4.38 times and is declining.

At the end of the quarter, we held nearly $3.4 billion in liquidity from cash on hand and revolver capacity. And in January, we issued $3.7 billion of investment-grade bonds and bank debt as shown on slide 22 and we increased the size of our revolver, all of which will be used for general purposes, pending maturities and buybacks. Pro forma for the repayment of our $3.25 billion of investment-grade notes maturing in February and April, our weighted average cost of debt declines to 5.2%. Our weighted average life of debt is over 11 years. Over 90% of our debt matures beyond 2021 and over 80% of our debt will be fixed rate.

So, we have a prudent and unique capital structure. And consistent with how we regularly evaluate our leverage target, we don't currently expect to be a material cash income taxpayer until 2021 at the earliest meaning $1 of EBITDA at Charter is not the same as elsewhere from a leverage or free cash flow perspective. We also have strong visibility on EBITDA growth and accelerating cash flow growth, meaning we can mechanically delever quickly if we see a permanent increase in refinancing cost, a change in business outlook or investment opportunities.

During the quarter, we also repurchased 4.3 million Charter shares and Charter Holdings common units, totaling $1.4 billion at an average price of $314 per share during the fourth quarter. And since September of 2016, we've repurchased about 19% of Charter's equity.

Briefly turning to our taxes on slide 13, our tax assets are primarily composed of our NOL and our tax receivables arrangement with Bright House and are worth over $3 billion.

So, we're looking forward to 2019. Our customer revenue and EBITDA growth, combined with decline in capital intensity and tax assets will drive accelerating free cash flow growth. And we expect that free cash flow growth, combined with an innovative capital structure and reasonable leverage target and an ROI-based capital allocation, to drive healthy levered equity returns.

Operator, we're now ready for Q&A.

Q&A

Operator

Your first question will come from Jonathan Chaplin from New Street Research. Your line is open.

Q - Jonathan Chaplin {BIO 4279061 <GO>}

Thank you. Chris, thanks for breaking with tradition and giving CapEx guidance. I think it's extremely helpful. Just two quick questions, if I may, on CapEx. During the prepared remarks, you mentioned that CapEx declines would continue. Did you mean that CapEx will continue at sort of around this level for cable of around $7 billion? Or is there a path for it to move even lower than that in future years?

And then, similarly on the costs side, you mentioned the reduction in activity now that you've got most of the customer-facing integration efforts behind you. Should we think of non-programming costs being stable at these levels with all of that activity behind you? Or could non-programming costs in sort of aggregate dollar terms come down a little bit from here? Thank you.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

So Jonathan, it's Tom. On the CapEx guidance going forward, we do think that in general going forward beyond 2019 and beyond our guidance, that capital intensity will come down. That's a function of revenue growth and continued opportunities to be more efficient with our capital spending. But I think the best way to think about it is that it really depends on how fast you're growing, to some extent, and how fast the opportunities to become more efficient are in terms of your customer service infrastructure.

So, I think that we'll leave it as we said it, that it's generally getting more efficient because of the operating opportunities that the network configuration provides us, meaning cloud-based services, IP-based services, lower CPE. But connected to your other question about non-programming cost, we think that that will also be down materially going forward, as a result of our ability to self-service customers and our ability to provide a better customer service experience, which will reduce transactions in general. That reduces capital and it reduces operating costs. So, we actually think we end up in a world with higher margins and lower capital intensity.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

Just to add one thing to that, Jonathan, in case you're modeling it, which I suspect you will be. The OpEx per customer relationship is going to come down materially, as Tom said. Depending on growth, if today we're growing customer relationships by 3.5%, I mean, our goal is to accelerate that customer relationship. So when we talk about the cost per, it's really in the context of cost per relationship having a material decline. Given the fact that we had elevated bad debt last year and that's now behind us, I do think there's an opportunity to also reduce it on a gross basis, but I think the key point here is it's tied to customer relationship growth and the cost per customer relationship is going to decline substantially this year.

Q - Jonathan Chaplin {BIO 4279061 <GO>}

Great. Thank you very much.

Operator

Your next question today will come from Ben Swinburne from Morgan Stanley. Your line is open.

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

Thank you. Good morning. Just sticking with CapEx, Tom, could you talk a little bit about your vision for the video business, particularly as it relates to sort of Bring Your Own Device, you guys have that Apple announcement recently.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Yeah.

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

It seems like that's becoming a bigger part of how the customer is consuming your product. I know your app is a top app on Roku. Just sort of theoretically and philosophically, how do you think about embracing that change and what it means to the business?

And then just for Chris, the CapEx step down in 2019 on cable is more significant than we were expecting. We knew about 3.1 rolling off all-digital, but those are relatively modest numbers in the grand scheme of the decline you're pointing out. So maybe if you could just enumerate the other drivers of that step down that are material just to help us think about what happens over the longer term, that would be helpful.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

All right, Ben. So on the video business, which we've talked about a lot, obviously, the video business is going through changes. But there's a lot of consistency as well in the video business in terms of the way bundled packages still remain the primary services that we offer.

I think we embrace where the marketplace is going. And we want to have people use video services on our network. And we think there are ways for us to be in the connected video business in a way that continues to provide incremental margins for us being in that business at the same time using the video business to drive our core business, which is connectivity.

And the mix of direct-to-consumer and the mix of direct-to-consumer hardware Bring Your Own Device in the video space, I think will change through time. And we're going to allow it to change as the market dictates and try to make our products work best on every device that we provide. There's still significant opportunities for us providing CPE devices to consumers, bringing in all of their services together in one consistent way.

That said, there are consumers that definitely want CPE and there may be CPE vendors that create great CPE. And we're open to being a supermarket of video services, however, those services develop. And we think that we can run our traditional models and new models simultaneously. And when we look at video usage on our network it's actually going up.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

Ben, on the CapEx step down, the question remitted to the amount of – the significant amount of step down, which is already going to start to occur in the first quarter of this year. You hit at some of the big ones on the head. It's all-digital, it's now complete. DOCSIS 3.1 is now complete.

Another item is that the SPP migration naturally starts to slow. We now have over 70% of the acquired customers that are now migrated already into SPP, and just as you get further up the curve that level of migration slows.

We've been in two-and-a-half years of pretty intense integration and a lot of those integration programs have either completed or the heavy expenditure related to them is completed. I'll give you one big example. A lot of the software development that we've talked about in order to be able to put all of the call center and field operations into a national standardized, virtualized and specialized structure, a lot of that spend has occurred. And while some of those platforms are still being rolled out during 2019 and there's capital associated with that, the level of CapEx attached to that is lower. Same thing would apply for a lot of the in-sourcing where we've done – where there's tools trucks – tools and equipment and the big one there is also real estate when you think about call centers. It doesn't mean that some of that activity is not still going on in 2019. It is but it's just at a significantly lower level.

So those are big programs that are either wound up, or winding up. There are a couple of other trends that exist inside the business that will be continuing to go forward to improve the capital expenditure per passing or the capital expenditure per customer relationship. Some of it also ties to OpEx as well. We are increasing our self-installation rate. And so that has a impact both on OpEx as well as CapEx. And then the other areas that for a lot of the reasons that Tom just mentioned we are having a lower amount of new video CPE per installation.

Some of that comes about because of the market trends that Tom was talking about and our ability to service that marketplace. The other piece comes from the fact that we just deployed so much new CPE in the context of all-digital and through the SPP migration that you have a fully populated base of really capable video set-top boxes that are both comm and IP (33:49) capable in the marketplace. That means on the increment when you're replacing a churning customer with a new customer, the need to go out and buy new CPE is significantly reduced from what it's been in the past couple of years.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

The one thing I would also add is that, the mix of capital that we're allocating and the capital we do spend is increasing toward the network which is the Internet, and the speed and the capability of the Internet. And so while video, the cost per byte video CPE are coming down and the cost to provide customer connectivity in the home and service throughout the home are coming down due to the ability to self provision relationships. The actual investment in the network capability itself is going up, all the while capital intensity is coming down in aggregate for the whole business.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Ben.

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

Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Michelle, we will take our next question.

Operator

Your next question comes from Doug Mitchelson from Credit Suisse. Your line is open.

Q - Douglas Mitchelson {BIO 1897051 <GO>}

Well, thanks so much. Tom, I know it's early, but are you seeing the benefits from the reduced service interactions so far in 2019 or perhaps better as would be for systems that have already completed customer phase integration efforts previously? Any comments on sort of progress on customer comps would be helpful.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Right.

Q - Douglas Mitchelson {BIO 1897051 <GO>}

And for Chris, I'm a bit confused on margins. If I look at 4Q ex advertising, it looks like margins are down slightly year-over-year. You talked about growth in customers which is good for margins. There was, Tom, I think mentioned lower churn which is good for margins. Would I have it right that investment in integration and in-sourcing is still hitting the margins in 4Q and if that's right, how does that progress in 2019, does it get better right away in 1Q 2019 or does it get better throughout the year? Thanks.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Well, on the cost to serve issue, Doug, we did say in the fourth quarter that we saw churn reductions, those churn reductions come from our ability to manage the operation better, including how we create new customers but also the quality of the service infrastructure that we're providing and its impact on customer life.

And so to the extent that we're able to create a satisfied customer base by creating products at reasonable prices that have low friction in them from a relationship perspective, meaning we have less service calls and we'll have less friction in the transaction and scheduling of activity that creates an environment where the average customer life gets greater, and you have less transactions per consumer. And that means that you have less cost per consumer.

And so you can have – so in a static environment without growth, you get significant margin improvements. And in a growth environment you get less expensive growth environment. And so that's how we see the business developing and why we made the investments we did.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

Doug, your question on Q4 not looking at the analysis that you're starting to do. My guess is that you've either included mobile operating cost and/or you haven't backed out advertising cost associated with political. So advertising if you just took out the political advertising, but didn't take out the expense related to that, you might be able to get to where you were coming out.

But our margins when adjusted for political advertising margin and with leading mobile outside increased year-over-year. As it relates to 2019, our goal for the entire year 2019 is on the cable side to increase our margin, and some of that will depend on product mix and rate of growth. But our goal is to increase margin year-over-year in the cable side despite as you pointed out the lack of political advertising inside 2019. So that means organically quite a good development on the margin front.

As it relates to quarter-to-quarter there's seasonality depending on the level of connects typical in most cable companies Q1 through Q4. So I'd rather not get drawn into the seasonality and sequential development, but for the full year that's our goal subject to some of the caveats I mentioned.

Q - Douglas Mitchelson {BIO 1897051 <GO>}

All right. That's helpful. Thanks.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Doug. Michelle, next question please.

Operator

Your next question comes from Jessica Reif Ehrlich from Bank of America Merrill Lynch. Your line is open.

Q - Jessica Reif Ehrlich {BIO 17655233 <GO>}

Thank you. I have a couple of questions. First, I guess the video question. NBC News direct-to-consumer potential offer seems really interesting for the pay-TV industry. I was just wondering what your view is on that service, as a churn reducer or a revenue generator. On advertising, I mean, while this may have been expensive, your growth was really at the top-end of anybody's number. So wondering what you're doing differently?

And then finally on 5G, would love to get your reactions to what AT&T said yesterday on their call that 5G will replace fixed broadband. Can you talk about your views of Charter positioning as 5G rolls out?

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Sure. There's a lot there. On the NBCU opportunity, I think they have a good point and there is a huge opportunity in creating advertiser-generated programming services for the business and they're less expensive. And so I think there's details to work out there. But I think conceptually it makes a lot of sense.

In terms of our ad sales growth, I do think we have created, using analytics and other methods, a better advertising model that allows us to create higher CPMs for our advertising business and therefore to generate more money out of that business than other advertisers in the broadcast space who don't have those capabilities.

We have a unique two-way interactive plant. We have the ability to target advertising and to help our advertising customers get more effective advertising in the television space. And we're taking advantage of that. We've also built a great sales force and we're on the streets. And we own a lot of local markets in terms of our capabilities as a sales group. And we've reaped the benefit of that in our ad sales growth in 2018.

With regard to 5G, we're going to 10G. And our network is highly capable and we have a pathway to 10-gig symmetrical now spec'd out that we announced at CES as an industry. We just went to 1-gig, as you know, in 2018 and rolled that out across our footprint. And that's faster than the 5G fixed wireless deployments that have been spoken about so publicly.

And we think that broadband consumption, data consumption will continue to grow at a very fast rate and that our network is easy to upgrade, inexpensive to upgrade and quick to upgrade to take advantage of the future marketplace that this massive data throughput – that that growth dictates will be required.

So when we look at 5G as a fixed mobile business, it is possible to use it that way. It's not very efficient from a capital expenditure perspective, in our view, because you need essentially to spend an awful lot of capital to get close enough to the home to actually make 5G work effectively. So we're comfortable with our network and its capability. We're comfortable that broadband data consumption will continue to grow rapidly and that we can provide a better broadband experience at less cost than alternatives.

Q - Jessica Reif Ehrlich {BIO 17655233 <GO>}

Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks. Next question please, Michelle?

Operator

Your next question comes from Vijay Jayant from Evercore. Your line is open.

Q - Vijay Jayant {BIO 1526830 <GO>}

Thanks. Just wanted to come back on the video product. Can you just sort of talk about where we are on kind of the Spectrum Guide rollout? Has it sort of been a real differentiator in terms of reducing churn and sort of take up? And then, obviously, your broadband product has really improved over the last year. Can you talk about how share shifts are trending in markets where there is a fiber alternative by the telcos versus taking your share? Where is really the fight coming out right now? Thank you.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

So, Vijay, we're rolling our Guide out on the increment as a result of the transaction and the bringing of the networks together, which were all somewhat incompatible from a CPE and network architectural perspective. We changed our Guide architecture to some extent. But we're now rolling it out on the increment pretty much everywhere and it is a significant improvement. Not that our existing experience in most of our markets isn't good, but the Guide that we have is better and we think without a lot of data yet, that it will provide a more lasting experience for the consumer.

We've also put that Guide on our apps and we've put the Guide in our CPE that we're retailing and in the CPE that others are retailing for us and it's actually getting distributed quite rapidly in that space. So we think it's an excellent consumer experience. And we think that it'll add to our ability to do what I said earlier in the video business, which is to both sell bundled packages, stream packages, à la carte packages and to do those in a way that is coherent and consumer friendly across all devices in the home including our own mobile devices.

In terms of share shift, we continue to shift share pretty much everywhere we operate. And I guess some more than others but our share is generally with very few exceptions shifting toward us.

Q - Vijay Jayant {BIO 1526830 <GO>}

Great. Thanks so much.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Vijay. Operator, our next question please.

Operator

Your next question comes from Philip Cusick from JPMorgan. Your line is open.

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

Hey, thanks guys. Nice to see that we're coming out of this transition and I'm thinking about churn, you said churn is coming down, it's what we'd expect. Can you remind us how churn in the Legacy Time Warner and Bright House basis compare now to Charter? And I'll go from there.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Chris, why don't you do that?

A - Christopher L. Winfrey {BIO 16326284 <GO>}

So across all three Legacy entities Phil, churn is coming down year-over-year, which means that Charter just continues – Legacy Charter just continues to get better. There's still a market difference between the churn rate at Legacy Charter which is the lowest and TWC and Bright House. Bright House because it has the Florida markets, probably is going to have a more elevated churn just due to the mover ratio that exist in those markets. Otherwise the service...

A - Thomas M. Rutledge {BIO 1818216 <GO>}

The snowbird effect.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

That's right. And so I think there's still a long runway for both TWC and Bright House and Charter even over the past two and a half years has continued to get better and better on a churn ratio. But there's at least 10% differential that exists in the churn rates in Legacy Charter to those other entities.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

But just to put that into – in Legacy Charter, the SPP or the pricing and packaging that we use is well into the high 90% range. And so you get the effect of the lower churn in that environment and we're seeing the churn come down consistent with historic trends in Legacy Charter. But interestingly, Legacy Charter comes down, while Time Warner and Bright House come down. So the whole trend is improving, but there's still more significant upside in Time Warner.

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

And the first derivative is bad debt. Can you remind us where bad debt was sort of early in the process versus in 4Q? And I guess that will continue to come down as well.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

Fourth quarter was a reduction year-over-year and I expect that to improve.

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

And last thing. You were very clear that the fourth quarter was a tough comp year-over-year on subs. Should we think of 1Q as a fairly easy comp? Or is anything else going on that we should consider...

A - Christopher L. Winfrey {BIO 16326284 <GO>}

I wouldn't call it an easy comp. I mean, the things that we've always said before, I want to make clear, I'm glad you raised it, just because you hit January 1st and a lot of these programs and a lot of this disruption has slowed down quite a bit, doesn't mean that there's a complete seismic shift overnight.

Similar to what we saw at Legacy Charter, there's momentum that gets built up in the marketplace and most customers existing or non-subs don't wake up on January 1st and say now that disruption has stopped, let me either retain the service or subscribe. So I think it's still going to be a continuous improvement over longer periods of time. And I think looking at single quarters as a indication of long-term success of the operating strategy isn't really the right way to do it. So I'm not saying it's an easy or a difficult comp, but I don't think that there is anything that makes it an easy comp in Q1 year-over-year. And we expect to continue to improve throughout the year.

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

Thanks very much.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Phil. Operator, next question please.

Operator

Your next question comes from John Hodulik from UBS. Your line is open.

Q - John C. Hodulik {BIO 1540944 <GO>}

Great. Maybe guys if you could just talk a little bit about the ramifications of your new way of selling voice substituting the wireless into the wireline. First of all, does that mean we should see accelerating losses on the traditional voice side? Or are we at the right run rate?

And then two, is there any margin implications? Or would that be swamped by what you guys are doing on the non-programming side? And I guess maybe just wrapping it up together in terms of margins, I mean you still show a sort of meaningful gap in terms of overall margins, cable margins versus say your larger competitor. I mean, how do we expect that to trend over time? And is there any reason why that gap shouldn't close as you guys get through these duplicative costs and see all the initiatives you're doing on the non-programming side play out? Thanks.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Well, yes. I'll speak to the mobile selling question. Yes, it's a significant transaction change in our model. And yes it has implications to wireline. We've seen – as you know we – as part of that we've reduced the cost of wireline to less than $10 with the idea that it was a bolt-on product to a triple play with mobile. And so it has some implications to what will happen to wireline sell-in. We look at our wireline performance relative to all other wireline providers, it's significantly better. But how much of an impact that marketing change will have against a general trend of wireline substitution, hard to say, but we don't think it's that material a driver to our economic performance. And we do think it's a good value for a lot of consumers.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

I think it gives you a good retention price point over time. And those new customers coming in, they are not subject to the same rate roll-off discussions because it's a $10 add-on both at promotion as well as at roll-off and so it's always a tack-on value-added service and that $10 it's less attractive to turn it off at a later point in time.

In terms of the margin implications, John, in the majority of our markets our double play acquisition pricing is at $90 whereas our triple play in the majority of our markets used to be $90. So I don't think there's any dramatic margin implications on an incremental basis going forward of what we're doing. So we sell double play in the majority of our markets in video and Internet at $90 plus the mobile add-on to the extent somebody values the fixed line voice service, it's a $10 tack-on from there versus an attractive price and it's not subject to some of the roll-off churn that you would've seen in the past.

In terms of cable margin gap, I don't see anything between us and, for example, another large-scale cable operator that prevents us from being able to get to similar cable margins over time. The only caveat I'd say is that we are a pure-play cable operator, which means all of our corporate and overhead costs are embedded inside of when you look at cable for us, it's there. And so there's a bit of a dissimilarity which is inherent, if we were a conglomerate and had a whole host of different businesses and Tom Rutledge and Chris Winfrey equivalents wouldn't be inside the cable business per se, but that's...

A - Thomas M. Rutledge {BIO 1818216 <GO>}

We're not going to be knocking the margins down that much.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

No. All right. So that's good to hear. So that's the only thing I'd say. But I think as a general notion, we've always said that we thought there was an ability to, despite having programming cost increases year-over-year to be in a business that could generate over 40% EBITDA margins in cable and our view on that...

A - Thomas M. Rutledge {BIO 1818216 <GO>}

And still be a growth business.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

...and still be a growth business and our view on that hasn't changed.

Q - John C. Hodulik {BIO 1540944 <GO>}

Okay, great. Thanks guys.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, John. Operator, we have time for one last question, please.

Operator

Okay. So our final question today will come from Amy Yong from Macquarie. Your line is open.

Q - Amy Yong {BIO 16207054 <GO>}

Thanks. Chris, I guess, just following up on the voice question. Can you help us think through ARPU going forward? There just seems to be a lot of moving parts. It looks like you pushed through a surcharge, but you're obviously also retooling the sales process. Just wondering how we should think about it going forward. Thank you.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

Yeah. Look, given what I just said to John, I don't think the voice changed itself. From a total relationship perspective, it's going to have that much impact on customer relationship ARPU. If anything, you might argue that it could be slightly positive. But the GAAP allocation of revenue amongst these products is a hornet's nest. And I, for years, said I think the best way to take a look at what's happening with ARPU is take a look at ARPU per customer relationship and the trend there.

And when you get down to that, then it's pretty simple. You have the promotional pricing of the bundle of products you sell, you have the roll-off, you have any rate increases. And the big one that falls in there which is pretty easy to model is the amount of single-play Internet sell-in, which even though it's attractive, has the impact of lowering your per relationship ARPU. And that's the biggest offset to the other factors that I just mentioned.

So I would not try to model individual product line ARPUs, because I think it's a pretty deep GAAP allocation question. I'm not sure if that's useful to the public. I think the customer relationship ARPUs is the way to look at it, which is why we talk about that metric as opposed to some of the others.

Q - Amy Yong {BIO 16207054 <GO>}

Got it. Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Amy. That concludes our call. Thanks everyone.

A - Thomas M. Rutledge {BIO 1818216 <GO>}

Thank you everyone.

A - Christopher L. Winfrey {BIO 16326284 <GO>}

Thank you.

Operator

Thank you, everyone. This will conclude today's conference call. You may now disconnect.
