Q4 2017 Earnings Call

Company Participants

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

Other Participants

- Bryan Kraft, Analyst
- Jason Boisvert Bazinet, Analyst
- Jeffrey Wlodarczak, Analyst
- Jessica Jean Reif Cohen, Analyst
- John C. Hodulik, Analyst
- Philip A. Cusick, Analyst
- Vijay Jayant, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Kim, and I'll be your conference operator today. At this time, I would like to welcome everyone to Charter's Fourth Quarter 2017 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. Thank you.

Stefan Anninger, you may begin your conference, sir.

Stefan Anninger {BIO 15867691 <GO>}

Good morning, and welcome to Charter's fourth quarter 2017 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 number of risk factors and other cautionary statements contained in our SEC filings, including our most recent proxy statement and Form 10-K. 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. We may also refer to pro forma results. While the Time Warner Cable and Bright House transactions closed on May 18, 2016, these pro forma results present information regarding the combined operations as if the transactions have closed on January 1, 2015, in order to provide a more useful discussion of our results.

Unless otherwise specified, customer and financial data that we may refer to on this call for periods prior to the third quarter of 2016 are pro forma for the transactions as if they had closed at the beginning of the earliest period referenced. Pro forma reconciliations are provided in Exhibit 99.1 to our Form 10-Q filed on November 3, 2016.

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. Additionally, all customer and passings data that you see in today's materials continue to be based on legacy company definition.

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. 2017 was a formative year for the new Charter. We executed well and accomplished what we set out to do in our plan. Our integration from three legacy companies to a unified company, with one service and operating approach, is on schedule. Our business is growing quickly and the most challenging elements of our integration are behind us.

Our 2017 customer results were as planned. For the full year, we grew total customer relationships by nearly 4%, despite all the significant changes we made to our business. Quality sales have increased and the worst of Legacy Time Warner Cable churn is behind us. In the fourth quarter, we continued to see year-over-year improvement in customer connect volumes in our new markets.

Spectrum, our high-value product set, is now the majority of our services, with over 50% of former Time Warner Cable and Bright House residential customers now subscribing to the Spectrum pricing and packaging. Nearly all of our video connects are purchasing our expanded basic video product and our total expanded video relationships grew again this quarter.

We now offer minimum Internet speeds of 100 megabits in 99% of our entire footprint, up from just over 50% in June of last year. We grew full year revenue by 3.9%, or 4.5% excluding advertising, and EBITDA grew by nearly 6%.

In addition to the launch of our Spectrum pricing and packaging, we also made meaningful progress in consolidating our customer-facing applications and platforms in 2017. We reduced and unified our various video applications, so that today virtually all of our customers, regardless of the footprint or package, use a single Spectrum TV app to access our IP-based video products.

We largely integrated our VOD content offerings and we consolidated our sales and service portals. We also continue to integrate our three legacy networks' backbone and facilities and to rationalize our IT systems and product and provisioning platforms. Over the last 18 months, we've hired thousands of new employees into good jobs in the communities we serve, creating a more in-sourced service and delivery workforce. That local hiring is driving higher-quality craftsmanship, improved product delivery, and better customer experience, and at the same time, we've rationalized our management structure, driving significant reductions to our overhead costs.

In addition to in-sourcing, we've also been unifying our service personnel practices. That means having calls from anywhere handled by agents in a consistent way. Our in-market workforce standardization efforts and our simplified pricing and packaging are beginning to drive efficiencies into our operations. In the fourth quarter, for example, billing-related service call and billing-related calls from Legacy Time Warner customers were down by 15% year-over-year. And average call handle times have been reduced as our in-house employees provide better, more efficient services.

Still, 2018 will be another busy year of integration for Charter. We remain focused on a number of key customer-facing initiatives, which will position us for faster customer relationship creation and long-term financial growth. We continue to drive penetration of our Spectrum pricing and packaging in our new markets, selling Spectrum branded services to new customers, and migrating legacy customers to Spectrum, including small business customers. That process underway for over a year, drives one-time investments and puts some short-term pressure on revenue in order to extend customer lives and drive higher customer revenue and returns over time.

On the operations front, we'll continue to in-source more of our field operations and our customer care workforce in 2018. We're streamlining our billing platforms and infrastructure. And by 2019, all of our customer care personnel will be working from a single, virtualized platform with unified frontend for all sales, billing, provisioning, service and retention efforts nationwide, allowing any one of our care personnel at any call center to handle customer calls from any location in our national footprint.

In June of last year, we restarted our all-digital project and at the end of 2017, 30% of Legacy Time Warner Cable and 60% of Legacy Bright House Networks continue to carry full analog video lineups. Those regions will be fully digitized by the end of this year as we deploy fully functioning two-way digital set-top boxes on all the remaining analog TV outlets that we serve.

Our video products in those markets will improve, Internet speeds will increase further, and all-digital will drive more efficient operations in the field, including electronic disconnects, self-installation, and a reduction of unauthorized connections. We also continue to develop our core products. In 2016 and 2017, we delayed a number of new product launches through the integration, particularly at Legacy Charter. With our fundamental structure operating model and business rules now in place, we will more aggressively launch new products nationwide.

Our primary hardware for video customers in all-digital will be our Worldbox, our faster, less expensive, and more powerful set-top box, which we've deployed approximately 2 million to-date. Over the course of the year, we'll expand our streaming video and on-demand library to approximately 50,000 HD titles in multiple digital formats.

By the end of 2018, we expect the Spectrum Guide to be available to essentially all new video customers, allowing us to fully expose the depth of that large content library. That includes Legacy Charter markets that are contiguous with Legacy TWC or Bright House markets and what we call mixed markets, like Los Angeles, where we waited to roll out Spectrum Guide to the full DMA at the same time.

Existing customers in those markets will, over time, have the choice to switch to Spectrum Guide from their remote. We'll also begin offering popular third-party applications, including Netflix and others, on Spectrum Guide, making our set-top box a hub for accessing content that originates from us or from somewhere else. Those applications will first appear on our Worldbox, then across legacy box types over time.

As our fourth quarter video results demonstrate, we are having success with our new video products, and we're testing and launching new and traditional video stream products without equipment to better serve the consumer demand for more choices and economical options. In December, we began launching our gigabit speed offering in several markets using DOCSIS 3.1 technology. Today, we offer gigabit services in eight markets, approximately 9 million passings.

By year-end, we will offer gigabit services in virtually everywhere we serve, all 50 million passings. And in December, we raised the minimum Spectrum Internet speed to 200 megabits in markets like New York, Hawaii, Austin, and Charlotte at no additional cost to consumers. In the fourth quarter, we also began deploying our Wave 2 Wi-Fi router, which offers faster speeds and better propagation and reliability throughout the home.

Turning to wireless, we are on track to launch our new services in the middle of this year under our MVNO agreement with Verizon. Chris will discuss the financial implications of that launch, but the goal is to create and retain more cable customers. Our 5G wireless tests are also going well, as are our 6G tests, which is our pre-spec definition of the integration of small cell architecture using unlicensed and licensed spectrum working together interchangeably with our advanced DOCSIS roadmap to create high-capacity, low-latency product offerings. We expect that, over time, our existing infrastructure will put us in a unique position to economically deploy new powerful products that benefit from small cell connectivity.

In 2017, we announced a partnership with Viacom and AMC, which will produce original content for the Spectrum video platform before subsequent windowing. Working with our long-standing programming partners allows us to leverage their expertise in creating compelling original content, as well as to defray cost. We hired a seasoned original content executive to help us manage these partnerships and evaluate new ones with our existing programming partners.

Our experience with our local Spectrum News networks, like New York 1 and Bay News 9 in Tampa, has demonstrated that well-branded and high-quality programming can have a meaningful differentiation and customer retention benefit. So we have another busy year of execution ahead with some meaningful product enhancements planned, and we remain confident in our plan and our growth potential.

Before turning the call over to Chris, just a few comments on tax reform and the elimination of Title II. At the end of last year, Congress and the President passed the Tax Cut and Jobs Act, which we see as very positive for American competitiveness and a significant incentive for infrastructure development. The FCC also eliminated the Title II rules implemented in 2015, returning to the net neutrality framework that has been in place since the inception of the Internet. Charter is committed to net neutrality. We've never violated open Internet principles and we have promoted consumer-friendly practices, like not imposing data caps or usage-based billing.

There is a growing discussion about permanent legislative solutions to codify net neutrality principles and online privacy protection. That kind of solution would establish a level playing field for all companies and will promote regulatory certainty we need to make investments.

Last year I said subject to the tax reform and FCC moving the Title II framework, we would hire over 20,000 American workers and invest over $25 billion here in the U.S. over a four-year period. In 2017, we increased our U.S.-based workforce significantly, and we increased our capital expenditures by 15% to $8.7 billion. We also increased our broadband availability to underserved communities, including rural areas.

Those statistics increased throughout 2017 as we grew more confident that tax reform and FCC actions to promote net neutrality for all market players would be enacted. Late in the fourth quarter, we accelerated the 2018 deployment of our Spectrum Gig offering. In a number of markets, we doubled our minimum Internet speeds from 100 megabits to 200 megabits at no additional cost to our customers, and accelerated testing of the new integrated wireline and wireless products.

Tax reform and the removal of Title II overhang incent companies to invest more and build larger U.S.-based workforces with good paying jobs. Based on those regulatory reforms, we're announcing today that we're committed to paying every employee at Spectrum at least a $15 per hour income this year. That's in addition to the significant medical and retirement benefits we've already increased for our employees. Investing in our own locally based workforce with more training and better wages for craftsmanship results in higher-quality service and drives value into our business.

Now I'll turn the call over to Chris.

Christopher L. Winfrey {BIO 16326284 <GO>}

Thanks, Tom. Before covering our results, a few administrative items. First, I want to remind everyone that when I reference fourth quarter 2017 customer results, I'll be comparing those to the fourth quarter 2016 results that have been adjusted to exclude seasonal program customer activity in the fourth quarter of 2016 at Legacy Bright House. We've provided that year-over-year comparison on slide 6 of today's investor presentation.

Additionally, as we head into the second year of our integration, the distinction between pure integration activities and the implementation of our operating model is blurring. So starting in the first quarter of 2018, we no longer will disclose transition expenses in our P&L or transition-related capital expenditures, although this cost will still occur for some time.

Page 6 of today's trending schedule provides a mapping of historical transition expense into our regular expense lines, so those who'd like to adjust models in advance of the first quarter reporting can do so now. That trending schedule also shows a line flip we'll make in Q1, hauling down sales and retention expense, we will move from costs to service customers to marketing, where these call center activities are now managed. We haven't reflected that change in the fourth quarter financials, but wanted to highlight the change before Q1.

Finally, our fourth quarter 2017 results were modestly impacted by the third quarter storms in Texas and Florida. There is no negative impact to subscriber results or revenue in the fourth quarter. The fourth quarter storm-related operating expenses and capital expenditures were immaterial, under $10 million combined.

Now, turning to our results. During the fourth quarter, total customer relationships grew by 206,000 from 1 million customer relationships in the last year, with 3.4% growth at TWC, 3.9% at Legacy Charter, and 5.4% at Bright House. Including residential and SMB, video grew by 15,000, Internet by 300,000, and voice by 53,000.

49% of residential TWC and Bright House customers were in Spectrum pricing and packaging at the end of the year. Customer connects were up year-over-year in our new markets. And as slide 6 shows, we grew residential PSUs by 287,000 versus 213,000 last year.

Within last year, TWC residential video customers declined by 2.5%, pre-deal Charter declined by 1%, and Legacy Bright House grew its video customer base by about 0.5%.

Within the quarter, TWC residential video net adds were flat, with continued growth in traditional expanded customers offset by continued churn and migration from the lower base of limited basic customers. We also had growth in our Stream offering, which is a lower priced video product that doesn't require equipment and is targeted at customers who don't currently buy a video product from us today. We marketed that product more actively and widely across the footprint in the fourth quarter.

Legacy Charter lost 10,000 residential video customers in the quarter versus a gain of 20,000 a year ago, driven by our integration focus on the larger acquired footprint. As Tom mentioned, getting to a national product and service standard also caused us to adjust the timing of product upgrades across Legacy Charter for over two years.

In the meantime, we've seen some additional competitive build-out of pricing and promotional offers advertised by competitors, and we had less of a benefit this year from integration struggles at a key competitor. We also merged some Legacy Charter markets into the Legacy TWC service infrastructure, as we created new regional operating areas. That puts certain Legacy Charter areas into a pre-upgraded state with respect to service.

Bright House gained 13,000 video customers versus a loss of 6,000 last year. In total, we added 2,000 residential video customers in the fourth quarter in addition to SMB growth. In residential Internet, we added a total of 263,000 customers versus 303,000 last year. Over the last 12 months, we grew our total residential Internet customer base by 1.2 million customers, or 5.4%, with 5.1% growth at TWC, 5.6% growth at Legacy Charter, and 6.9% at Bright House.

In voice, we grew residential customers by 22,000 in the fourth quarter versus 1,000 last year, and higher triple-play sales offset by higher churn of legacy packages at TWC. So subscriber results will continue to improve. We expect further success with a higher portion of the base in Spectrum, as well as the launch of new products. But, as we've said before, the progress will not be linear, particularly as we go through the positive and negative short-term effects of all-digital, new product launches, and business integration with each of these often staged to cross-markets.

Within last year, we grew total residential customers by 828,000, 3.3%. ARPU growth remained muted, given modest price increases, continued stand-alone Internet sell-in, higher sell in at promotional rates, and migration activity at Legacy TWC and Bright House to Spectrum pricing and packaging. There is also a mechanical ARPU hit from the changes to the Legacy Bright House seasonal plan.

Slide 7 shows our customer growth combined with our ARPU growth resulted in year-over-year residential revenue growth of 4.0%. Total commercial revenue, SMB and enterprise combined, grew by 6%, with SMB up 4.5% and enterprise up by 8.3%. Excluding cell backhaul and NaviSite, enterprise grew by over 12%. Sales were up in both SMB and enterprise, with 32% higher SMB PSU net adds at TWC and Bright House in the fourth quarter versus last year.

Our revenue growth in the TWC and Bright House market hasn't yet followed the unit growth, and it won't until we get through the transition to more competitive pricing in both our SMB and enterprise products. We expect that ARPU offset will continue through 2018, but the revenue growth will ultimately follow the unit growth.

Fourth quarter advertising revenue declined by 17% year-over-year, driven by political in the prior year. Excluding political, advertising revenue grew close to 3% year-over-year, given the higher year-over-year local, national, and digital revenue. In total, fourth quarter revenue for the company was up 3.2% year-over-year and 4.2% when excluding advertising.

Looking at total revenue growth, excluding advertising at each of our legacy companies, TWC revenues grew by 3.9%, pre-deal Charter grew by 5.1% driven by customer growth, and Bright House revenue grew by 4.2%.

Moving to operating expenses on slide 8. In the fourth quarter, total operating expenses grew by $199 million, or 3.1% year-over-year. Programming increased 10.8% year-over-year, driven by contractual rate increases in renewals and a higher expanded customer base and mix, which accounted for roughly 3% of that programming cost growth.

For the full year 2018, we expect programming cost for video customer to grow at a slower rate than 2017. That reflects the significant amount of programming renewed in the last 15 to 18 months. And that expected decline in growth rate applies, whether or not you include the small investment we expect to make in exclusive original content, which Tom mentioned.

Cost to service customers declined by 0.4% year-over-year, driven by the benefits from the combination of three companies, productivity benefits from our operating model, partly offset by higher bad debt expense from higher customer acquisition levels and revenue. Marketing expenses also grew by 7.8% year-over-year due to the higher level of marketing and sales activity. And other expenses were down 2.7% year-over-year, driven by the elimination of duplicate costs.

Adjusted EBITDA grew by 3.3% in the fourth quarter; excluding transition costs in both periods, adjusted EBITDA grew by 1.8%. There is still lot of moving parts, and we won't pass up opportunities to grow, but the fourth quarter probably reflects the low point of our EBITDA growth rate for cable, should also benefit from some political advertising later in the year.

Turning to net income on slide 9, we generated $9.6 billion of net income attributable to Charter shareholders in the fourth quarter. $9.3 billion of that is related to a non-cash tax benefit, given the reduction in our deferred tax liability as a result of tax reforms. Much of that deferred tax liability was put on the balance sheet as part of purchase accounting related to our transactions. We generated $454 million in net income in the fourth quarter of last year due to a gain from the re-measurement of our pension liability.

So leaving aside the pension gain last year, the tax gain this year, adjusted EBITDA was higher, severance-related expenses were lower, and we recognized $101 million benefit in this fourth quarter from the re-measurement of our liability from the Advance/Newhouse tax receivables agreement also due to tax reform. Those benefits were partly offset by higher depreciation and amortization, and higher interest expense.

Turning to slide 10, capital expenditures totaled $2.6 billion in the fourth quarter, including $202 million of transition spend. Excluding transition, fourth quarter CapEx increased by $682 million year-over-year, primarily driven by higher spending on CPE, scalable infrastructure, and support. Our fourth quarter CapEx included purchases for 2018 activity, including significant CPE inventory purchases for the much larger all-digital activity this year and for DOCSIS 3.1 and scalable infrastructure.

For both all-digital and 3.1, there is a significant operating and procurement benefits to stage inventory and equipment in 2017 for launches in 2018. Excluding the impact of transition and any "pull forward spend," fourth quarter CapEx was still higher year-over-year, with higher CPE and given higher connect volumes, higher set-top box placement rate per connect, and the migration of legacy customers over to Spectrum, who are frequently provided with new equipment.

We also had all-digital spend, which excluding the inventory staging I mentioned, totaled about $70 million in the fourth quarter. We also spent more in the support categories, on vehicles, tools, and test equipment, software development, and facility spending, in each case some related to insourcing and some related to integration.

As we look to 2018, our cable capital expenditures should be driven by many of the same factors as last year, including customer growth, Spectrum migration, all-digital, and insourcing and integration. In total, we expect cable capital intensity or capital expenditures as a percentage of revenue to be a bit lower than 2017.

Next year, 2019 that is, should deliver a meaningful decline in capital intensity and dollars. Continued revenue growth improvement remains the best path to that efficiency, and all-digital will be complete, we'll be on the back half of our integration, and the bulk of Spectrum packaging and DOCSIS 3.1 upgrade spending will have occurred already in 2017 and 2018. And even with video unit growth, the dollars of video CPE should also dramatically drop with a fully deployed base of modern two-way set-top boxes with the DOCSIS modem inside.

Slide 11 shows, we generated about $1.2 billion of free cash flow in the fourth quarter versus $1.9 billion in the fourth quarter of last year, and that decline was largely driven by the higher CapEx. We finished the quarter with $69 billion in debt principal, and our run rate annualized cash interest expense at December 31 was approximately $3.7 billion, whereas our P&L interest expense in the quarter suggests a $3.4 billion annual run rate. That difference is due to purchase accounting.

As of the end of the fourth quarter, our net debt to last 12-month adjusted EBITDA was 4.47 times, at the high end of our target leverage range of 4 to 4.5 times.

2017 was a busy year of financings for us. We executed over $26 billion of debt transactions, about $17 billion for refinancing, and the balance partly funding our share repurchases. Our refinancings have extended the weighted average life of our debt to 11.5 years from the 11.1 at the end of last year, and today over 85% of our debt matures after 2020. So, very attractive maturity profile.

We also upsized the revolver by $1 billion to enable more strategic flexibility, including around buybacks. And we did all that without raising the weighted average cost of our debt, which today stands at 5.4%, as it did a year ago. During the fourth quarter, we repurchased 13.5 million shares in Charter Holdings common units totaling $4.7 billion at an average price of $347 per share. For all of 2017, we bought back $13.2 billion, also at an average price of $347 per share.

Slide 11 shows over a 16-month period, we spent $14.8 billion on repurchases, reflecting 14% of the company's fully diluted equity. The raising of our leverage by about 0.5 turn over the last year to the high end of our target range, reflects the confidence we have in our operating model and what we knew would drive complexity in our operating statistics throughout 2017.

We're not changing our target leverage range of 4 to 4.5 times despite the material positive cash flow impacts from the tax reform, which I'll cover in a moment. The fact that we're currently at the high end of that leverage range versus the 0.5 turn increase in 2017 mathematically means our 2018 buybacks will be less than 2017.

But other factors also played a role, including the launch of our local products with working capital effects from consumer devices. And I don't expect that we can achieve the same level of working capital improvement for cable in (29:39) 2018, given the effects of the 2017 CapEx pull-forward on 2018 working capital and our expectation for the lower capital purchases in late 2018 with the completion of all-digital and other large integration projects, which has an impact to the 2018 working capital.

So no guidance on buybacks other than, we like what we did when we did it in 2017. 2018 will be less and we'll remain opportunistic to preserve flexibility to create shareholder value without getting trapped by artificial targets.

Turning to taxes on slide 13. At Charter, we expect to see significant cash tax savings over the long-term from tax reform. These tax savings and the FCC actions to remove the Title II framework will support the significant commitments that Tom made on Charter's behalf at the White House last year and the extension of those commitments today.

The imminent passing of tax legislation in December was already a factor in the fourth quarter capital investment acceleration I mentioned previously, specifically around the benefits in the fourth quarter 2017 bonus depreciation. Anticipating greater regulatory certainty was a key factor in accelerating our DOCSIS 3.1 deployment, including Spectrum Gig, and increasing minimum Internet speeds in a number for markets for Spectrum customers.

Lower taxes and higher regulatory certainty also create better incentives for new construction and more rural broadband deployment, which will utilize our deep fiber and anticipated wireless capabilities. We don't expect the tax bill to limit the use of our existing NOLs. And in the time scope of our current business plan, we do not expect material limitations on our ability to deduct interest for tax purposes, if ever. We also don't currently expect to be a material cash income taxpayer until 2021 at the earliest, and that's two years later than what we previously expected.

Given the lower federal tax rate and lower income from bonus depreciation, we estimate the total present value of our tax assets, reflecting a later NOL utilization against a lower rate, has declined from just over $5 billion to about $3.5 billion. That decline is offset by the much larger value associated with net present value of tax reform, which drives higher free cash flow in perpetuity.

Before we move into Q&A, I wanted to provide a financial framework for the launch of our Spectrum wireless services later this year. As Tom mentioned, we believe that our entry into wireless can further accelerate customer growth and drive penetration. The more customer growth we generate, the more incremental revenue we'll generate from wireless and cable. Much of that revenue in the beginning will be device contract revenue, which is fully recognized on the contract date, and similarly, as cost of goods sold under EIP accounting, with the actual customer payments received over a longer period.

As with any subscription business, there are upfront launch and acquisition activity, which creates OpEx and CapEx which exceeds the gross margin benefits in the short term. The more wireless customer growth we generate early on, the more EBITDA cash flow drag we experience in the early days.

In time, we expect our wireless service to generate positive EBITDA on a stand-alone basis with broader growth benefits to our core cable services. Our wireless business will eventually be fully integrated as just another cable product in the bundle from a marketing, care, billing, and service perspective, so no different than Internet or voice today. And it will not be a separate P&L or segment as such.

Through the launch phase, however, we will be able to isolate certain key items to create transparency around cable performance. Those items, not necessarily with line by line disclosure, will include service revenue, which could be messy with bundle allocation effects of pricing and any subsidies, device revenue and related cost of goods sold, the MVNO cost, or selling cost, and any direct CapEx.

We should be able to isolate the working capital impacts from the timing of cash flow for device cost and related to subscriber cadence. We will provide additional details on the wireless business as we move through the year and as the business scales, but our current goal is to maintain our target leverage on a consolidated basis even through the launch phase.

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

Q&A

Operator

Thank you. And your first question comes from the line of Bryan Kraft with Deutsche Bank. Your line is open.

Q - Bryan Kraft {BIO 20667157 <GO>}

Thanks. Good morning. I just had two questions. One, Chris, can you talk about what the tax rate would be on a permanent basis, if you take out the benefits of the NOL and the depreciation timing? So we can start to think about how we model that tax rate in the out-years of our models.

And then secondly, I know you don't want to talk about how much of the synergies in dollars have been realized and you're going to no longer disclose those. But can you just talk about roughly where you are in realizing the transaction synergies, maybe in terms of rough percentage terms or something, just so we can think about how much still could be on the come as we go forward? Thank you.

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

Sure. So in terms of tax reform, one of the key elements in addition to a lower rate was bonus depreciation for the next five years, and then a fairly logical transition out of 100% bonus depreciation. So your question is, at a point where Charter does become a taxpayer, maybe ignoring the ongoing benefits of our NOL, the effective tax rate should be in the 24% to 25% area, all-in inclusive of state income tax.

As for synergies, right, we're not providing ongoing disclosure. Part of that is also the distinction between what are operating model synergies and transaction synergies, it's not a bright line. But I think if you take a look in our results for all of 2017 and in the fourth quarter, you can see that even in the areas of cost to serve and then the other expenses, and even in the marketing and sales area, where we have much higher sales and marketing activity, and we have synergies there that are offsetting some of those increases, we are doing everything that we intended to do on the synergy side. We expect it to get to the numbers we published over a three-year period. And we're not quite there yet, but we're well on our way. Beyond that, I think I'd like to avoid trying to put a pin into it, because it does become somewhat judgmental as to what's an operating synergy and transaction synergy at this stage.

Q - Bryan Kraft {BIO 20667157 <GO>}

Okay. Thanks very much, Chris.

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

Thanks.

A - Stefan Anninger {BIO 15867691 <GO>}

Kim, we'll take our next question please.

Operator

Thank you. And your next question comes from the line of John Hodulik with UBS. Your line is open.

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

Great, couple ones. First, Chris, there's some nice EBITDA commentary about this being a low point for cable EBITDA growth. First, a clarification, does that include any sort of impact you're going to see from the wireless launch midyear? And then if you could give us anymore color on what drives that accelerating EBITDA growth, is it more revenue-related or more margin related?

And then maybe for Tom, the 200 megabits per second service, can you give us a timeline for sort of how you expect that to be rolled out across the U.S.? And I realize it's early, but any sort of early feedback you can give on terms of uptake or improving subscriber numbers in those areas? Thanks.

(37:21)

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

The reason I mentioned cable EBITDA being at the low point was because it was specific to cable, and I'm not saying that now to spook anybody. But if we're wildly successful with wireless and there is upfront cost in terms of sales and marketing that's attached to wireless subscriber growth, so I don't want to get trapped into a point where we're regretting growth on something that ultimately is going to have significant cash flow contribution. So we think Q4 was probably the low point for cable EBITDA growth, and that's why essentially we said it that way.

In terms of the sources of that growth, as subscriber units have improved and we expect to continue to improve, (38:06) choppiness along the way, but over the medium and long term subscriber results continuing to improve, that has a significant impact on the revenue flow-through. We're also coming out of a year where we didn't have political advertising and into a year where we will have political advertising. So all of that implies that revenue should be a contributor to that EBITDA growth. We also mentioned in the prepared remarks that we expect a lower rate of programming cost growth, which does have an impact to the EBITDA growth rate as well.

And I think we'll continue to become more efficient on the operating side. There are some trade-offs there, and we have a lot of insourcing investments that are ongoing. But to answer your question, I think it comes from both revenue and certainly in parts of the cost structure continuing efficiency there as well.

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

Great.

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

So, John, with regard to our data speeds, so our plan is to go 1-gig everywhere in the -- that we serve essentially this year. So we'll have all 15 million pass essentially activated to 1-gig capability with our advanced wireless product with it, so that we can distribute the 1-gig throughout the home. The 200-megabit upgrade is currently about 18% of our footprint. And we have some plans to take that up further this year, but we have – it's really a logistical question. Part of that is, we're offering that to our existing customers as well. And in some cases, we have modem transfers to do, and so there are logistical issues in managing that.

So we haven't decided how fast we're going to go with that and how far we'll roll that out entirely this year. But to sum it up, we plan to be 1-gig everywhere and marketing 1-gig everywhere this year. We're just taking up a significant portion of our business to minimum speeds of 200 megabits at the same price we were charging for 60 a year ago. And we plan to do that as quickly as we can, but because of the all-digital rollout and some of the other operational issues we have, we haven't fully planned out to do the whole country yet.

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

Got you. All right. Thanks, guys.

A - Stefan Anninger {BIO 15867691 <GO>}

Kim, we'll take next question.

Operator

Thank you. And our next question comes from the line of Jason Bazinet with Citi. Your line is open.

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

Just a question for Mr. Winfrey. You do a nice job in your K outlining the aggregate transition expenses over the last three years, both on OpEx and CapEx. And I was just wondering if you could give any commentary about how much more transition expense you expect to incur in 2018, and is that the last year that there will be transition expenses.

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

Let me start with the easy one. No, it won't be the last year. I think, in 2019 we'll still have, from an IT infrastructure standpoint, some ongoing transition capital in particular, and also as we continue to converge some of the core networks into 2019. So I think it will go on through 2019.

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

Okay.

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

The reason we're no longer going to continue to provide that is, as we make changes through the business, some of that's really just to align to an operating model and sometimes it's to put in a brand-new overlying architecture. And so is that because it's the right thing to do for the overall business or is that because it's tied to integration, and making that black and white distinction was very easy early on.

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

Yeah.

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

And particularly at the end of 2018, making that distinction in a way that's faithful (42:08) that you can lay it out in your 10-K, which didn't – we thought it was a little bit harder and made it less relevant. And so what we wanted to do today is explain people why we were going to make the change, provide the transparency of where those line items would be recast in Q1, so that people have time in advance to recast it.

So I think you can already see the transition expense from an operating expense has been coming down. Some of that is because we're actually coming down in the activity, some of that is because it became harder to define, and when in doubt, we put it into the "business as usual" just because we'd rather be conservative.

And if that's the case, then providing that distinction becomes less useful over time to investors. And we thought it would be more transparent to show the transition that we intend to do in Q1 and report it back the usual way beginning in Q1 and going forward.

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

Perfect. Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Kim, we'll take our next question, please.

Operator

Thank you. And our next question comes from the line of Jessica Reif with Bank of America. Your line is open.

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

Thank you. I guess, two questions. You talked a lot about the certainty that you now have from regulation and also tax reforms done. How does that play into your views on further consolidation in the industry and how you would view participating in that?

And then secondly, can you give us more color on the original content strategy? How much content will you be buying from Viacom and AMC? Will it be exclusive? How will you use it or benefit from that? Thank you.

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

Yeah, obviously, M&A in the industry, if you're talking about cable M&A as opposed to programming M&A, from our point of view, we like the cable business. We think it's a good business. We think we can do well on it. And if there were opportunities for acquisitions at the right price, we'd always be interested in entertaining those. I don't know how the tax law or the Title II changes effect the regulatory environment for any M&A, if that's your question, and I'm not sure they do. And so we still have all the issues that we've always had in the industry in terms of M&A, as far as I can see.

With regard to content, yeah, our plan is to work with proven content companies to get economies that work for us in terms of windowing a content, and to use that content to create a brand halo around our products in an effective way in the marketplace. We've done two arrangements, one with AMC and one with Viacom, which are slightly different in scope, but they essentially create a window of opportunity for us to use content in a way that fits our customers and still together we monetize that content properly over a bigger distribution footprint, meaning the world. And so we'll see where it goes, but it's an opportunity to – for us to be associated over a period of time with original content.

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

Tom, I'm sorry, can I just – and one follow-up. Does that play into your efforts at all in what you're doing in targeted advertising? And can you give us an update on what advancements you've made in advertising?

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

Well, we continue to make significant advancements in advertising, and we're actually pretty bullish on our ability to grow our advertising business. As Chris said in his comments, we actually grew advertising, taking political out, by 3% last year. We are using more advanced data analytics, anonymized data analytics, to drive better advertising products into the market. We have in an all-digital environment the ability to use our inventory much more effectively and in a much more targeted way combined with good data, so that the advertiser gets a more responsive ad and we get a higher CPM. And so we have got investment plan for 2018 to finish out our platform, to deliver that nationwide. We have made significant strides to-date. And so we have a much more advanced advertising platform than we had historically, and we're beginning to see traction.

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

Great. Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Jessica. Kim, we'll take our next question, please.

Operator

Thank you. And our next question comes from the line of Phil Cusick with JPMorgan. Your line is open.

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

Hi. thanks. Two, if I can. First, Chris, can you give us some clarity on the rate increases announced so far, both in the Legacy Charter and the acquired plans, and how should we think about any ARPU impact this year?

And then maybe Tom, can you talk about wireless a little bit more? For the midyear launch, should we expect something like a Comcast-type MVNO or something substantially different? And when could we start to see you offering some type of your own cellular augmentation rather than just using Wi-Fi in addition to the MVNO? Thank you.

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

So, Phil, we have not taken significant rate increases inside 2018, really consistent with our operating philosophy to go for market share growth. We did have some small rate increases to true-up for retransmission expense, and that's flowed through at the beginning of January, but that's really to offset a direct expense that we have.

We've also harmonized some of our set-top box rates, in some cases that resulted in a small increase. But as you know from the transition to Spectrum pricing and packaging, in many cases that's a dramatic reduction in set-top box fees that are paid by consumers. And so it really was more about standardization than a flat-out rate increase.

Those were the two biggest items. We had some other small modifications around the edges, but those were the two that drive the most significant portion. But in general, our strategy is to drive revenue growth through unit growth as opposed to simply taking rate. That hasn't changed.

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

Well, with regard to wireless, yeah, we do plan to rollout a mobile product. We already are in the wireless business today. We have 200 million authenticated devices connected to our Wi-Fi network. We plan to sell mobile product using the Verizon MVNO. We haven't decided how to price it. But our long-run view of pricing is that we should offer good value for high-quality products, and we should integrate that into our overall product and packaging scenario, so that the consumer ends up with a set of high-quality product features in a single customer relationship and that those features individually and in aggregate are worth more to the customer than it would be as stand-alone products. And so we haven't decided our pricing.

I would say this about Comcast quite candidly did a really nice job with their pricing model and has a lot of very positive attributes. But we have yet to decide ours or announce ours.

With regard to the Wi-Fi and licensed spectrum opportunities, small cell radios, if that's what you're referring to, which I referred to in the past is a inside-out strategy essential for high-capacity, low-latency services to be delivered to consumer premises and businesses. We've been experimenting with various licensed and potentially unlicensed – some of the spectrum is unclear of what its long run regulatory status would be. But we're experimenting with different spectrums that we hope will become licensable or private along with Wi-Fi. But Wi-Fi, interestingly, continues to increase in terms of its actual capability. We are doing this 1-gig service throughout the country with Wi-Fi, and Wi-Fi can handle 1-gig. And so that's the kind of speed that people are talking about from a 5G perspective.

So our thought is that we may want to take additional licensed spectrum and combine it with Wi-Fi spectrum to create an even broader in home, in business, and mobile platform. We don't have any current plans to launch that in 2018, or 2019 for that matter, but we're working on the integration of licensed and unlicensed spectrum into the same radios, so that we can improve the already good wireless coverage that we provide in home.

I think the most interesting fact to consider about just the MVNO which we're about to enter, 80% of the bits that mobile carrier customers receive on their devices come through our Wi-Fi network. And so it's a robust network and it's getting better.

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

Thanks, Tom.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Phil. Kim, we'll take our next question, please.

Operator

Thank you. And our next question comes from the line of Jeff Wlodarczak with Pivotal Research Group. Your line is open.

Q - Jeffrey Wlodarczak {BIO 1940808 <GO>}

Good morning. One for Chris and one for Tom. Chris, you bought back dramatically more stock certainly than I anticipated in the fourth quarter and the second half of 2017. Should we assume going forward you're going to stay at the high end of your 4 to 4.5 times leverage target?

And then for Tom, I wanted to get your thoughts on the potential for the government to nationalize a portion of the mid-band wireless spectrum to create a competitor into 5G? And then just on 5G in general, you've done a lot of work on fixed 5G. How much of a competitive threat do you view telco fixed 5G your core data business? Thanks.

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

So, Jeff, on the leverage question and specifically related to buybacks, we did a lot of buybacks last year. And the reason that we took our leverage up by 0.5 turn, still within our target leverage range, is because we knew all the changes that we were making inside the business with make Charter statistically challenged for a short period of time, because the higher amount of sales and higher-quality sales were being masked by legacy product churn and migration. And it was very difficult – despite us talking about it, it was very difficult for people to see. We had confidence of where it was going and we thought that was the right window to take our leverage up and buy stock at these prices, in effect $347 per share both over the full year and inside of Q4.

But as you point out, we're now at 4.47 times leverage, so mathematically, if we're going to stay in our target leverage range, and we intend to do so on a consolidated basis, including the wireless launch cost, then it doesn't leave a whole lot of headroom. We do have EBITDA growth and we have cash flow, and both of those contribute to capacity. But I think we did what we did, and we liked it and we liked the price we did it, liked how aggressive we were, we thought the timing was right.

In the course of this year, where do we take leverage? It's too early to say. I think a lot of that is dictated by the opportunity set that's in front of us. I would say that our goal is to stay consolidated leverage at 4.5 times, in a weird way, to the extent that we become more and more bullish about our ability to drive wireless growth, you would want to make sure that you've left enough capacity in your consolidated leverage to be able to still be within the target, that's our goal. And if you saw M&A opportunities that came about, which haven't existed in a material way recently, then that would also factor into wanting to create some headroom.

And most importantly, as I mentioned before, while subscriber results did what we said they were going to do and continue to do so, there's going to be choppiness along the way, just given the amount of change that we're driving in the business. So it won't be a straight line. The overall curve over a medium- to long-term, we have high confidence in that. If there are reactions to choppiness along the way and the opportunity opens up, that's one of those strategic opportunities we'd look at as well. And no guidance on where we'll be inside the 4 to 4.5 times, and that's simply because we need to keep that flexibility to go make the right decisions, which I think so far we're pleased with.

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

So, as far as the national 5G government built mobile network, which I assume you mean.

Q - Jeffrey Wlodarczak {BIO 1940808 <GO>}

Yeah.

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

I didn't know if there is such thing architecturally even possible with the pre-spec notion. There is no 5G spec yet. And to do it in a mobile environment would mean a massive amount of very tiny cells. And could government manage something like that? It's hard to conceive. And I don't know any – I understand the security issues that I think underlie how that concept got into the public space, and I do think there are significant cybersecurity issues that we have to deal with as a country and privacy issues that are real policy issues, but I just can't imagine a nationalized infrastructure. And I don't even know from the mobile platform what the product would be.

When it comes to 5G fixed, I think it's – you got to remember, 5G is just a format to the SIM data at a certain speed and there are alternatives to 5G, which is why we talk about 6G. It's kind of like number 11 on Spinal Tap (58:05). There are a lot of ways to get speed, 5G isn't the only way to provide high-capacity and low-latency network.

And so, what is a 5G fixed network? It sounds to me like it's a wireless drop that costs more than a wireline drop. And what do you attach it to? You have to attach it to a network, just like you do all wire drop connections. And so I see all the same kind of costs necessary to build a 5G network as there is to build a wireline network, and maybe more. And so will that – does that potential exist? Does anyone with enough capital want to do that? And will they get a return to that capital? I don't know. But I think it has much of the same aspects of investment as wireline, if not greater.

Q - Jeffrey Wlodarczak {BIO 1940808 <GO>}

Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Kim, we'll take our last question, please.

Operator

Thank you. And our final question comes from the line of Vijay Jayant with Evercore. Your line is open.

Q - Vijay Jayant {BIO 1526830 <GO>}

Thanks. Two, if I may. Tom, there were some comments in the prepared remarks about the Stream product becoming a bigger piece of mix. Just want to get your thoughts on the virtual MVPDs and how they're scaling, what's the sort of response broadly in the marketplace, and do we expect these IP products to be a bigger piece of the mix going forward?

And just very quickly for Chris, you obviously talked about the trough EBITDA trends ex-wireless, possibly we're there right now. Maybe just talk about the arc on the commercial side, where you're sort of doing a similar thing, is that behind the consumer arc on the recovery, just for our understanding of scaling of the business going forward. Thanks so much.

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

Well, in that – what you are asking me to describe what's going on in the video business and it's complicated, there's a lot of issues out there. I still think that we can grow video. I think there are lot of pressures in the video business with the pricing and packaging, pricing the product, and the fact that in order to carry the whole product, you have to buy the whole product as a distributor, and which makes the retail price generally expensive for a fully featured service.

There are lot of other people being priced out of the market and price/value relationship is declining, because, among other things, it's gotten more expensive, but also the cost of not paying for it has gotten cheaper, meaning with password sharing and lack of control by programmers over their content, you have an easy ability to substitute pay TV for free TV. And you can do that with an antenna for broadcast television, which has now become an expensive product, and you can do that with streams product that isn't properly managed.

So you have price pressure in the business that's significant. You have income levels that can make price pressure significant. So the overall category is shrinking from pay perspective for all of those reasons. And then you have our ability to sell, which I think is still good and significant, and I think that we have the ability to put better video products in front of the consumer and package them. There is no product out there that I can see that we don't have access to, to sell to our consumers or to provide to our consumers and integrate into our existing services.

So I think we have an opportunity to continue to have a fully featured video product that meets customer expectations. That's equivalent to what anyone else can do. And therefore, I think, because we have a better business model and better infrastructure, that we can win against satellite and we can win against other wireline competitors in the marketplace and grow our video business, but the overall category, I think, is still under enormous pressure for all the reasons that I cited.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Vijay. That ends our call. Thanks, operator.

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

Just that we didn't ignore Vijay, I forgot he had the second question on commercial.

A - Stefan Anninger {BIO 15867691 <GO>}

Oh, okay.

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

The commercial migration, what's happening in commercial, sales are up significantly. I mentioned in the prepared remarks 32% year-over-year growth at TWC and Bright House on SMB from a unit perspective. That's really significant. 32% increase in net adds. The trade-off to that is ARPU pressure, and so similar to residential with migration that's been taking place, the key difference in SMB, and the same applies to enterprise, is the pricing differential is greater and the time for it to occur is longer. So the SMB migration takes a longer period of time, as does enterprise.

So I think we're going to see similar pressure throughout 2018; not giving a revenue guidance, other than to say we'll have a positive unit growth, we'll have positive revenue growth, but it's just going to be depressed through 2018 relative to the unit growth until we can get a little bit further on in that migration path and get over the 50% points in what we've been talking about on residential.

A - Stefan Anninger {BIO 15867691 <GO>}

With that, I think that does wrap us up. I apologize. And thanks, everybody, for joining the call.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. You may now disconnect.
