Q2 2018 Earnings Call

Company Participants

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

Other Participants

- Amy Yong, Analyst
- Benjamin Daniel Swinburne, Analyst
- Bryan Kraft, Analyst
- Craig Eder Moffett, Analyst
- Douglas Mitchelson, Analyst
- Jessica Jean Reif Cohen, Analyst
- Jonathan Chaplin, 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 Charter's second 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 second 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 and 10-Q. 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>}

Thanks, Stefan. During the second quarter, we saw higher sales of our products across each of our legacy footprints. As of the end of the second quarter, 62% of residential Time Warner Cable and Bright House customers were in our Spectrum pricing and packaging, up from 55% at the end of the first quarter. Over the last year, we've grown our total Internet customer base by over 1.2 million or 5.2%, faster than any other provider of any scale in the United States and video net losses were less than in Q2 of last year.

Our customer growth remains strong despite our significant integration activity and the short-term disruption it creates. In the second quarter, we grew total revenue by 4.8% year-over-year, including residential revenue growth of 4.6%. Adjusted EBITDA grew by 6.2%, when excluding mobile. And we remain confident in our ability to accelerate growth through higher sales, lower churn and by increasing operational efficiency, all resulting in higher revenue per passing and lower operating and capital costs per relationship.

During the quarter, we rolled out our gigabit speed offering to more than 20 million additional passings using DOCSIS 3.1 technology. We now offer gigabit service to approximately 60% of our footprint. And we'll finish our full upgrade to DOCSIS 3.1 by the end of this year at very low cost and relatively little outside labor or physical construction. We've also raised our minimum Spectrum Internet speed to 200 megabits in about 40% of our footprint at no additional cost to our customers. We're raising our Internet speeds faster than originally planned in order to maintain our superior competitive position and it's working.

Now turning to wireless, later this year, we'll begin launching the initial version of our new wireless 802.11ax router. This new device will not only deliver multi gigabit speed throughput in future products, but also broader coverage throughout the home, and even more support for a higher number of concurrent devices of constant set of applications like video streaming and voice.

On June 30, we soft launched our Spectrum Mobile service under our MVNO agreement. We now offer mobile service to both new and existing Spectrum Internet customers at highly attractive prices. Our Unlimited service costs $45 per month and our By the Gig service is $14 per gigabyte. Both products offer unlimited talk and text and customers can change between plans mid-month.

The launch has gone very well and we're scaling the operation, which is intentionally generating relatively small order volume at the moment as we ramp up features and marketing throughout the summer. In the next few months, we'll expand our mobile capabilities, offering a wider array of mobile devices and giving customers the ability to transfer their existing handsets. We'll also expand our mobile sales channels, including offering our new service in a greater number of retail locations.

Spectrum Mobile offers new and existing customers the opportunity to save hundreds of dollars per year on their mobile bill, all while bundling that service with our superior and value-rich broadband and other connectivity services. Ultimately, the goal is to use Spectrum Mobile to attract and retain more multi-product customers, driving faster customer growth, higher penetration and greater EBITDA per passing.

Our all-digital initiative is on schedule for completion by year end. 91% of our total footprint is now all-digital. And at the end of the second quarter, only 6% of legacy Time Warner Cable customers continued to carry full analog video lineup, down from approximately 40% at the end of 2016. Approximately 50% of the Bright House footprint still carries analog signals, mostly in the Tampa area where we've started to go all-digital in June.

By the end of this year, the whole company will be fully digitized as we deploy fully functioning two-way set-top boxes, mostly our WorldBox, on all remaining analog TV outlets that we serve. Together with Spectrum Guide fully deployed at new connects, flexible streaming packages, consistent IP user guides and the introduction of our cloud-based DVR product later this year, we will have made our video product competitive and consistent nationwide.

In the meantime, the traditional video marketplace continues to be challenged by: a combination of continued programming rate increases, with rights tied to carriage of multiples services and packaging limitations; new over-the-top and virtual MVPD options, often with poor security and negative profit margins; and changing customer viewer behavior. Those trends aren't new. And given the outsized programming cost increases, video as a standalone service has been a declining margin business for some time.

And despite that, we've managed to and expect to continue to grow our EBITDA and cash flow consistently and at healthy rates. Cable's success as an industry, despite the challenges of standalone video product margin pressure, is because at our core, we provide connectivity. Going back to its inception as community access TV, retransmitting free over-the-air signals or developing broadband Internet or landline voice, and now a WiFi mobile product, the transport or connectivity business is what we've always been.

We've never looked at product-specific margins at Charter, but rather at the profitability and returns of an individual customer or passing. We continue to add new services to our network and increase our revenue per passing and lower our cost per dollar of revenue by adding significant value to as many customers as we can connected to that network.

As part of a service package, video drives connects, reduces churn and drives higher satisfaction and remains an integral part of our business strategy, even though it drives less standalone profit over time. That video relationship helps us market our connectivity services and advanced advertising to both new and existing customers. What a video subscriber or viewer is and how the video market is defined is changing, while total video consumption is going up.

If we execute well, no one is better positioned to serve that video marketplace than we are, given that our network, including traditional and IP video platforms; our service infrastructure, both wired and wireless; our significant programming relationships and role in securing content and our own local content; and our ability to package and bundle services to drive overall connectivity relationship growth.

While we use video to drive connections, our business plan continues to assume that programming costs will continue to grow, that emerging video – or virtual MVPDs will aggressively price their product and that traditional MVPD market will continue to contract even though we're growing share. And whether or not our traditional video units grow a little or decline a little has little bearing on our ability to accelerate consolidated cash flow growth and create a lot of value for our shareholders.

As a reminder, we have shown our value creation model on slide 5 of today's presentation. Ultimately, our long-term growth opportunity comes from powerful, having an easy to upgrade network that allows us to offer data-rich wireline and wireless products that consumers want and businesses need. And our customer penetration, which is just above 50%, is low relative to where it should be, considering the quality of our wireline and wireless products today and in the future.

Business products have an even greater penetration upside. The capability of our plant will continue to expand with these advanced DOCSIS product rollouts and the convergence of our wireline and wireless architectures, allowing us to offer high-capacity, high-compute, low latency connectivity products both inside and outside of the home.

So we have an excellent runway for customer growth and a significant opportunity for operational cost efficiencies from improving products and service and reducing transactions. And our expected EBITDA growth, combined with our declining capital intensity, balance sheet strategy and tax assets, will yield industry-leading free cash flows per share growth in the coming years.

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. This is the first quarter which we presented our customer results using consistent definitions across all three legacy entities. On July 11, we issued an 8-K announcing that we had posted a revised trending schedule on our IR website and that trending schedule shows our customers results under the uniform methodology going back to the beginning of 2016 and provides a reconciliation schedule to our previous reporting.

As I mentioned on our last call, starting the third quarter of this year, I expect we'll only report consolidated operating statistics and revenue results. We may still call out legacy entity drivers where relevant, but we'll report as one company.

Finally, recall that starting on January 1 of this year, we prospectively adopted FASB's new revenue recognition standard. There are a number of relatively small adjustments in the quarter related to the adoption of the standard, both in revenue and expenses, which in total lowered EBITDA by a single-digit million dollar amount this quarter as compared to last year.

Now turning to our results. Total residential and SMB customer relationships grew by 196,000 in the second quarter and grew 884,000 over the last 12 months, with 3.2% growth at TWC, 3.3% at Legacy Charter and 4.2% at Bright House. Including residential and SMB, Internet grew by 267,000 in the quarter, video declined by 57,000, and voice declined by 8,000. 62% of residential TWC and Bright House customers were in Spectrum pricing and packaging at the end of the second quarter.

Second quarter customer connects were higher year-over-year in each of the Legacy footprints and while voluntary churn was lower year-over-year, total relationship disconnects were higher. The key driver was higher non-pay disconnects from integration-related system issues we discussed last quarter. Those issues were fixed and the non-pay churn from those issues is improving on the timeline we outlined.

To give a better sense of how the quarter progressed, consolidated residential customer relationship net additions were a little lower year-over-year in April, closer to prior-year in May, and in June, customer relationship net additions in video and Internet PSU adds were a bit better year-over-year for consolidated Charter and at each of the three Legacy entities.

In residential Internet, we added a total of 218,000 residential customers versus 230,000 last year. Total company Internet sales were higher year-over-year. As Tom mentioned, as of late 2Q, we now offer 200 megabits per second as our minimum Internet speed in about 40% of our footprint and we offer gigabit service in approximately 60% of our footprint. And we expect to have gigabit service available nearly everywhere by the end of 2018.

Over the last 12 months, we grew our total residential Internet customer base by 1.1 million customers, or 4.8%, with 4.7% growth at TWC, 4.8% growth at Legacy Charter, and 5.6% at Bright House. Over the last year, TWC residential video customers declined by 2.2%. Pre-deal Charter declined by 1.5% and Legacy Bright House video was flat year-over-year. Over the last year, over 100% of our total video net losses were from limited basic. In voice, we lost 45,000 residential video customers versus a gain of 14,000 last year, driven primarily by higher non-pay churn at TWC and lower upgrade and attach rates.

Over the last year, we grew total residential customer relationships by 714,000 or 2.8%. Residential revenue per customer relationship grew by 1.7% year-over-year, given the lower rate of SPP migration, rate adjustments, fewer limited basic customers and promotional campaign roll-off that was partly offset by higher levels of Internet-only customers and better sales with sell-in at promotional rates.

Slide 9 shows our customer growth combined with our ARPU growth resulted in year-over-year residential revenue growth of 4.6%. Beginning this quarter, our GAAP accounting allocated more revenue away from billed residential voice into primarily residential video, and a GAAP allocation between products has no impact on total residential revenue or revenue growth. But as we've noted in the past, our reported product revenue does not reflect revenue allocation on customer bills.

That's one of the reasons we stopped reporting individual product ARPU several years ago, because focusing on the product revenue and product ARPU growth rates does not reflect how we market and bill our bundled services. This reporting challenge is likely to grow over time with the introduction of mobile, which really just argues for (16:10) continued focus on total residential revenue, customer relationships, and bundling.

Turning to commercial revenue. Total SMB and enterprise combined grew by 4.4% in the second quarter, with SMB up 2.9% and enterprise up by 6.7%. Excluding cell backhaul and Navisite, Spectrum Enterprise grew revenue by 10%. Sales are up in both SMB and enterprise. And TWC together with Bright House have grown SMB customer relationships by over 11% in the last year.

Our SMB revenue growth in the TWC and Bright House markets 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.

Second quarter advertising revenue grew by 12% year-over-year, primarily due to an increase in political and advanced advertising products that allow for more targeted selling with better inventory utilization. Excluding political, advertising revenue grew by about 3% year-over-year. In total, second quarter revenue for the company was up 4.8% year-over-year and 4.5% when excluding advertising.

Turning to operating expenses on slide 10. In the second quarter, total operating expenses grew by $293 million or 4.5% year-over-year. Programming increased 5.8% year-over-year, driven by contractual rate increases and renewals and a higher expanded customer base and mix. Regulatory, connectivity and produced content grew by 5.1%, primarily driven by our adoption of the new revenue recognition standard on January 1, which reclassed some expenses to this line in the quarter.

Costs to service customers grew by 1.2% year-over-year, or roughly a third of our customer relationship growth rate. So even with the temporary impact of higher bad debt expense, we are lowering our per relationship service cost through changes in business practices and seeing early productivity benefits from ongoing insourcing investments.

Marketing expenses grew by 1.2% year-over-year, but benefited from lower transition costs this year. And other expenses were up 5.8% year-over-year, driven by higher IT cost from ongoing integration less synergy benefits and higher ad sales cost, insurance costs and enterprise spend tied to growth.

Excluding $33 million of mobile expenses, primarily launch-related, adjusted EBITDA or adjusted cable EBITDA grew by 6.2% in the second quarter. When including the impact of mobile, adjusted EBITDA grew by 5.3%.

Turning to net income on slide 11. We generated $273 million of net income attributable to Charter shareholders in the second quarter versus $139 million last year, and that increase was driven by higher adjusted EBITDA and lower severance-related expenses partly offset by higher interest expense.

Turning to slide 12. Capital expenditures totaled $2.4 billion in the second quarter. And the higher year-over-year spending was primarily driven by scalable infrastructure, support capital and line extensions. The increase in scalable infrastructure was related to more consistent timing of in-year spend, and planned product improvements for video and Internet, including spending related to DOCSIS 3.1 launches. We also spent more in the support categories on vehicles, software development and facility spend tied to insourcing, and about $45 million of which was related to our Spectrum Mobile launch, mostly in the way of software and stores.

Line extension spending was up year-over-year as we continue to build out and fulfill our merger conditions. CPE spend was down year-over-year given inventory build from the migration of customers to Spectrum pricing and packaging last year, an all-digital inventory build in the fourth quarter of last year and the first quarter of this year. We spent about $88 million in all-digital this quarter versus $5 million in the second quarter last year and $186 million in the first quarter of this year. So our CapEx spending is more level-loaded this year than last.

For the full year, we continue to expect a cable capital intensity or cable capital expenditures as a percentage of cable revenue to be similar and slightly lower than 2017. We also expect 2019 cable CapEx to be down in absolute dollar terms and in terms of capital intensity.

Before moving on to cash flow, I wanted to provide a brief update on our Spectrum Mobile product which, as Tom mentioned, launched on June 30 and is going well. During the quarter, we didn't generate any mobile revenue, but we had $33 million in mobile operating expense, driven by mobile-related personnel and overhead costs to prepare for our launch. That $33 million in negative adjusted EBITDA, combined with the total mobile CapEx of $53 million, mostly for software and stores, and mobile working capital usage of $30 million, yielded mobile free cash flow of negative $116 million in the quarter.

As Tom mentioned, we'll be launching additional devices and bring your own device options over the coming months, which will put us in a position for a broader market launch. The more customer growth we generate, the more incremental revenue we'll generate from mobile and from 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 customer payments for handsets received over a longer period, hence the working capital headwind.

The more mobile customer growth we generate early on, the more EBITDA and cash flow drag we'll experience in the early days, but we expect the incremental mobile P&L to be significantly NPV positive with broader growth benefits to our core cable services. We won't present mobile as a separate P&L or segment, but we will attempt to isolate the early effects on revenue, operating expense, CapEx and working capital, so long as the allocation of revenue still makes it relevant.

Should also mention that we finalized our mobile JV with Comcast this quarter with a portion of the funding representing an equity investment on our balance sheet and a portion representing a prepayment of software development and related services for the mobile back-office platform also on our balance sheet. As the partnership spends on development and service delivery, we reflect those services as capital or operating expense, depending on the nature of the services delivered.

Slide 13 shows we generated $804 million of consolidated free cash flow this quarter, including $116 million of investment in mobile that I mentioned a moment ago. Excluding mobile, we generated $920 million of cable free cash flow compared to $1.1 billion in the second quarter of last year. The decline was largely driven by a smaller working capital benefit than in the prior year timing, higher CapEx year-over-year, and higher cash paid for interest. That was partly offset by higher adjusted EBITDA and lower severance expenses.

We finished the quarter with $71 billion in debt principal. Our current run rate annualized cash interest is $3.8 billion, whereas our P&L interest expense in the quarter suggests a $3.5 billion annual run rate. That difference is primarily due to purchase accounting.

As of the end of the second quarter, our net debt to last 12-month adjusted EBITDA was 4.47 times, within our target leverage range of 4 to 4.5 times. At the end of the quarter, we held over $700 million in cash and additional revolver capacity of $3.9 billion. And in July, we repaid $2 billion of debt maturity and also raised $1.5 billion in the investment-grade market.

During the second quarter, we repurchased 6.4 million shares and Charter Holdings common units totaling $1.9 billion at an average price of $291 per share. Since September of 2016, we've repurchased nearly 17% of Charter's equity. We intend to stay at or below 4.5 times on a consolidated basis, including the impact of mobile on our financials.

So we're in good shape. At the end of this year, we'll be operating Charter as one company in a very competitive way. Spectrum pricing and packaging migration will be almost complete. All-digital will be done and we'll be offering Spectrum Guide to all new video customers. DOCSIS 3.1 and higher speeds will be available everywhere. Mobile will be fully launched, with a very attractive offer for cable sales and retention. And our service operations integration will be nearly complete, which we expect will continue to lower transaction volume and drive cost savings and service improvement.

There's still ongoing internal and customer disruption to make that happen. It is, for the most part, purposeful, so we can grow even faster sooner. The operating strategy outlined on slide 5 works and when combined with our tax assets, declining capital intensity and ROI-based capital allocation, leaves us very well-positioned to drive strong returns for our shareholders.

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

Q&A

Operator

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

Q - Vijay Jayant {BIO 1526830 <GO>}

Thank you. So a question first for Chris, if you sort of look at the cost of servicing customers, it's actually increased in the last two quarters while it was sort of down last year. Is that increase all sort of tied to the credit screening software glitch? And assuming that's sort of done by the end of 2Q, can that sort of revert back to declining?

And second, just a broader question, obviously, there was a story out last week that the New York PSC is probably going to revoke, request you to undo the merger in some form. Can you just talk about what are the implications there, how we should think about what that really means? Thank you.

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

Vijay, I'll answer the second part of the question first. We believe we're in compliance with the plain reading and the buildout requirements that the state imposed on us in merger conditions and we have a very strong legal case and ability to defend ourselves. And it could play out over a lengthy period of time if required.

Just to put it in perspective, we're operating in 41 states, we have thousands of franchise agreements and generally, we have good relationships with the communities we serve and we live up to our commitments, and we have in New York State. In fact, we're well ahead of our obligations in terms of speed upgrades and in buildout itself.

We do have labor issues in New York City which we believe have politicized the actions of the PSC, and so we're concerned about that. We've successfully negotiated other agreements with the same union, IBEW, in other parts of the country during this period. So we're hopeful that we can work all this out, but if necessary, we'll litigate and we believe we're in the right.

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

On the first question, Vijay, I think your question was cost to service customers, could it go flat again or even negative. We don't provide overall guidance much less line by line, but what I can tell you is the cost to service customers was essentially flat year-over-year, absent the increase in bad debt expense. And you have to take that in the context of still fairly significant customer relationship growth, which means that whether or not you exclude that temporary increase in bad debt expense, we're getting significantly more efficient at the same time that we're still making investments in insourcing. So I think that bodes well for the long-term of our ability to continue to get more and more productive on that line item.

And the bigger impact on that isn't just a cost impact, what it really means is that our customers are contacting us less, which means that they're having less service issues, service disruption, less billing related calls, less retention related calls, which means that churn is going down and your customer lives (28:52) are going up, as satisfaction is higher. And that really has an impact, a significant impact on the top line, which is the biggest driver for EBITDA and margin and cash flow growth over time. So you're right to focus on it and I think that it can continue to deliver an outsized benefit relative to the customer relationship growth over time.

Q - Vijay Jayant {BIO 1526830 <GO>}

Great. Thanks so much.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Vijay. Michelle, our next question please.

Operator

Next question comes from Jonathan Chaplin from New Street Research. Your line is open.

Q - Jonathan Chaplin {BIO 4279061 <GO>}

Thanks, a question for Chris. I'm wondering if you can give us some more context around your decisions on wireless pricing. So I think, Chris, earlier in the year, you suggested the expectation that you guys would be pretty aggressive in wireless with the launch. And with the pricing coming in higher than where Comcast was on a per gigabyte basis, I'm just wondering what you sort of learned from their experience and from your own testing and trials before launching. Are you thinking you'll be less aggressive in general or do you think you can take share aggressively at this level of pricing?

(30:17)

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

Yes. There's a lot to be said for the way Comcast prices and packages their product, we actually admire some of the things they did and think they're both good business and disruptive at the same time. But we make our own prices and our own analysis of the marketplace and this is where we came out on pricing for the long haul in terms of launching our business and being aggressive with our business.

I think if you really think about how you make the business grow, it's not just the standalone pricing of the business, but how you integrate it into your overall sales process, packaging process. And so whether we're aggressive or not is in the eye of the beholder, and obviously in terms of what kind of actual market share we take. I saw a statistic the other day, it was kind of interesting to me, which was that Charter's actually the largest wireline phone company in North America. And we've never sold phone as a standalone product. So you can do very well with a product but our intention is to use mobility as a feature of our overall customer relationship creation process.

Q - Jonathan Chaplin {BIO 4279061 <GO>}

Got it. Thanks, Tom.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Jonathan. Michelle, we'll take our next question.

Operator

Your next question comes from Ben Swinburne from Morgan Stanley. Your line is open.

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

Thanks, good morning. One for Tom and one for Chris. Tom, on the broadband product and all the improvements you're making, you talk about what your expectations are for Verizon's 5G launch, which I believe is coming to L.A. I'm not sure if it's going to be in your L.A. footprint but just generally, how you're thinking about the impact that may have on your business. And how are the higher minimum speeds that you've deployed and the 1-gigabit service is impacting your customer metrics here as we move into the second half, either sales or churn?

And then for Chris, thank you for the disclosure on the CapEx front on all-digital. Just to help us – remind us, how do you define all-digital spending? And should we be thinking about this what looks to be run rating $500 million-plus number for the year as sort of completely going away in 2019? And are there any other factors we should be thinking about, at least qualitatively, that may change next year versus this year on the CapEx side? Thanks.

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

So Ben, with regard to the speed increases, yes, there's a couple ways of looking at what we're doing with speed. We're taking and making our data product better and more competitive everywhere we operate, so that we can increase the rate of our growth and take share faster.

And we think that it's successful and that it's working where it's been rolled out. And as I said, we rolled out 20 million homes passed in the quarter and we're about 60% through our 50 million homes passed in general. So we're really just getting started from a speed marketing activation and implementation perspective. But it appears to be working where we thought it would and we expect to get higher growth rates in the future as a result of having a better product. It's that simple.

With regard to 5G, I look at what Verizon has announced as a kind of a conventional overbuild. Small cells require, essentially, a fiber optic cable system to supply them. So there's a lot of capital intensity with that kind of build. Their projection was to build 30 million passings in the United States over 10 years, which, if you believe that's going to happen, then 40% of those approximately would be in our footprint, if they deploy them with any kind of random distribution. And so you could do the math of what kind of penetrations you might achieve with a met-too product delivered wirelessly over a 10-year period in 12 million passings.

So I think it's a difficult process to use 5G as essentially as a wireless drop and it requires having all of the physical assets underneath that. So it's very capital-intensive and maybe as much or more capital-intensive than the conventional fiber build, like Google attempted.

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

Great. Thank you.

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

Ben, on all-digital, we define the all-digital capital expenditures, any and all incremental capital expenditure related to rolling out all-digital, the vast, vast majority of that sits in CPE and installation, but it would also apply to certain network spend that takes place right as we begin to take a particular market all-digital, but the vast majority of it's in the CPE category which includes installation.

Your question was also does it go away in 2019. It does. I think already, in the, particularly, the fourth quarter this year, you'll see it come down quite a bit because we'll have all the inventory replaced for the all-digital activity that we're going to do. The bigger point is not only will it go away in 2019, but our level of video CPE becomes permanently lower. And that happens because you've fully capitalized the existing base with set-top boxes and it happens because on the increment, we're deploying more of our video subscriber outlets in an IP format where it doesn't require a set-top box, which means that you can utilize returned set-top boxes for new customers without having additional CPE buy.

So I think our level of video CPE placement has peaked and is going to drop dramatically. It's fully capitalized with new boxes that are both IP and QAM-capable, and I think that just continues to improve over time. We'll also have in 2019 a lot less integration capital, DOCSIS 3.1 is a big spend last year and this year, that goes away. So I think the amount of CapEx reduction that we have going into last year is not going to be inconsequential both in dollar and percentage terms.

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

That's helpful. Thanks, Chris.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Ben. Michelle, we'll take our next question please.

Operator

The next question comes from Jessica Reif from Bank of America. Your line is open.

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

So hi. I've got three questions. First on advertising, your numbers were stronger than the industry is likely to be, just wondering if you can give some color on some of the things you're doing there. Then on SMB, the adds were so much stronger than revenue. Can you just talk a little bit about what will drive revenue growth going forward and maybe some color on what the underlying margins are?

And then finally, can you talk – I know this comes up a lot, but is there any interest in some kind of content, specifically Disney will be forced to sell the RSNs [regional sports networks] as part of the Fox acquisition. Could you comment on any potential interest in that?

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

Okay, I'll take advertising. This is a political year, and we have a lot of battleground states, although it appears that those continue to increase in quantity, so there's that effect in our advertising revenue. We're also growing our underlying advertising at the expense of other broadcast products essentially at the local level, but it's a difficult business. We've been investing and targeting and changing the nature of advertising itself, and we're selling a lot more data-infused products as well as digitals products themselves for advertising.

And so the revenue's going up and we're proud of it, but it's also – it's got a lot of winds behind its back in terms of having a political year. But the underlying core advertising business, too, you can almost look at the advertising business on biannual cycles, based on the political effect in advertising. But we're making headway at the core of our advertising product and our advertising business.

In SMB, you're right, the revenue growth is relatively small to the unit growth. And that's a conscious strategy based on our pricing and packaging. We think we're at about the nadir of growth in terms of revenue growth, meaning the decisions we made to reprice the small business marketplace and to drive a market share strategy means that we're growing very rapidly and creating increases in market share, which we expect to continue. And we had an existing base of subscribers who were mispriced in many cases, and that mispricing is coming out of the business. And we expect that going forward, that revenues will start to converge on the unit growth rate. And so we expect to have a significant and fast growing unit and revenue business going forward. And there's some of that in our enterprise business as well.

And lastly on content, our views on content haven't changed. A lot of content companies have come to us and asked us to buy them. And we so far not found a situation that made sense to us. We like our core business. We like our connectivity business. It doesn't mean that there isn't a possible content business that would be priced right for us, but there's no direct synergy, in most cases, for us in owning content.

Now we do have a different point of view on local news, and we've been investing in local news. We think it's an area where our assets and the product actually makes sense from a scale perspective. So we're about to launch a 24 hour local news channel in Los Angeles. And we've been doing similar repurposing of existing local sports and local news channels throughout the country and turning them into high quality local news channels. So our view on content is unchanged, regardless of the way the current marketplace is developing.

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

Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

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

Operator

Your next question comes from Bryan Kraft from Deutsche Bank. Your line is open.

Q - Bryan Kraft {BIO 20667157 <GO>}

Hi, good morning. Wanted to just ask you two questions. First on share repurchases, my impression has been that if you're going to use the high end of your target leverage range, it would be to pursue strategic opportunities. So I wanted to ask you, since you're near the high end now just through share repurchases, what's the appetite to stay at the high end of the range to repurchase shares or even go above the high end in order to take advantage of the stock price?

And then separately, one of your peers is growing programming costs per sub at less than 5% so far this year. Is there a reason for Charter's programming cost per sub growth to dip down to these levels at some point over the next couple of years or will the contract renewal cadence preclude that kind of outcome? Thank you.

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

So, Bryan, on the share repurchases, the amount of share repurchases we've been doing over the past couple quarters, just simple math, it's to your point, we've been staying at the high end of the 4 to 4.5 times. We are trying to make sure that we have enough headroom each quarter to stay within an LTM 4.5 times including the temporary impact of the mobile launch costs.

And, as I mentioned before, there's a little push and pull there as it relates to growth on mobile because of the temporary impacts you have, that could be higher. But the business at its core has a capability to delever a half turn, plus or minus, within a year. So to the extent strategic opportunities come about and you want to modify it because you think that's better, you have a way to get to what is a half a turn on Charter's a pretty substantial amount of capital, if you really saw something that had a better ROI relative to buying back your own stock. And that's the lens that we would look at it.

We have not had and we do not have a willingness to temporarily or permanently go above our leverage target. And the primary reason for that is that we do have $71 billion of capital. We have commitments as it relates to our investment-grade structure and we intend to honor those. And we think the long-term NPV of doing so is better not only for debt holders but for equity holders. And I'm not so sure that many of our equity holders would like to see us go above that in any event as it relates to just doing buybacks. So that's our stance. It hasn't changed and we are trying to be aggressive, given the recent stock price within those constraints, to buy back stock.

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

Yeah, I don't know what peer you're referring to on programming costs, but I would say this that because we are actually growing expanded video, and the video losses that we have incurred are basic-only, meaning broadcast-only video losses, we are actually growing our programming costs based on unit volumes. So if you're a programmer receiving payments from Charter, your programming costs are increasing due to volume. We're actually creating rich packages of video for our programmers. And so there's the unit cost and then there's the actual volume cost. And even though it looks like units are going down, from a programming perspective, they're going up.

Q - Bryan Kraft {BIO 20667157 <GO>}

Okay, thanks for the color on both. Thank you.

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

Thanks, Bryan.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Bryan. Michelle, we'll take our next question, please.

Operator

Your next question comes from Craig Moffett from MoffettNathanson. Your line is open.

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

Tom, in last night's proxy filing from T-Mobile, it looks as though there were interested parties in Sprint that it's easy to imagine Company A or Company B was likely Charter. I just wondered if you could comment on whether a year ago, you had interest in acquiring wireless assets and how you would view that today.

And then second unrelated question, I wonder if you could comment on John Malone stepping down from your board and we've got a lot of questions about that. Maybe you could share your thoughts.

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

Okay. Well, I don't know what's in the – I didn't read the proxy, unlike you, of T-Mobile, but we didn't make an attempt to buy any wireless assets. That isn't to say that we didn't have significant discussions with Sprint about an MVNO relationship. We had virtually no discussions with T-Mobile as I recall.

With regard to – just on that question of wireless convergence and assets, I think that our ability to create mobile customers and our ability to create wireless products on our network is sufficient right now, and that we have advantages in our network infrastructure that will allow us to build an inside-out strategy in wireless that we think doesn't require any kind of immediate mobile relationship other than an MVNO. It doesn't mean that sometime in the future mobile assets might be priced right and that natural convergence would occur, but there's nothing in our near-term horizon that dictates that we go that path.

With regard to John Malone, John is going to stay on as a director emeritus. He's been in the business 50 years. I love having him on the board. I'm happy that he's staying as director emeritus. He remains the control shareholder of Liberty Broadband, which owns about 20% of Charter, and he still has a right to appoint three board members and has. And we welcome Jim Meyer of Sirius to our board, and we think he brings real value to us.

We think that John will continue to be engaged with the company, that he likes the business. I like having him engage with the company. He brings tremendous insight to us, but he wants to reduce his workload and he's overboarding, so to speak, and he's just reached a point in his life where he feels like he has to. But we do board meetings in Denver and we may do them in Florida. So we think he'll be involved with us for years to come.

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

Thanks, Tom.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Craig. Thanks, Craig. Michelle, we'll take our next question please.

Operator

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

Q - Douglas Mitchelson {BIO 1897051 <GO>}

The declining video subscribers is manageable and programming costs would continue to rise, and that seems like a less combative stance than I've heard from you previously. And I, for one, personally doubt you'll be less combative. So I'm trying to understand how do you – what are the execution imperatives to manage the declining video subscriber base? Do you have to reduce overhead costs? Do you have to do skinny bundles or package definitely in the future? Does traditional programming relationships break down at some point?

And then for Chris, a question I know you're going to love. You know that mobile will be significantly NPV positive over time. Obviously, we're all trying to figure out that path. So I guess the question is what penetration of customers or homes or broadband customers does mobile have to reach to reach NPV breakeven? And since you won't answer that, how long to breakeven overall? Or any metrics at all we can use to try to think about how mobile's going to impact numbers over the next few years would be super helpful. Thanks.

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

We appreciate your candor, first of all.

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

And your love. So look, we're going to be aggressive and we're going to use video aggressively. But what we're saying is that it isn't really a standalone product in its current situation. People have been asking this question about video for a long time now and well more than five years, probably closer to 10 – maybe the whole experience of video broadcasting was dead when I got into the business 40 years ago and it's still around.

So what you can – even though you can see the future, it's very hard to say when. I would say that there's a lot of forces still holding the traditional MVPD relationships together, including what you just saw with Disney acquiring the Fox assets. And there's still a large group of very large content companies that control significant linear and sports content. And that's all contractually bound together in packages.

So while there is some degradation in the whole relationship and it has become overpriced in many cases, and it's actually pushing people out of the marketplace, that said, video consumption is still high. And part of that is because video is free, in many cases, because of the security that's on a lot of the virtual MVPDs and the TV Everywhere products and the password sharing on other over-the-top products. All of that is putting pressure on traditional video, but at the same time, it's the perfect way of selling content. And so it isn't just going to go away overnight.

How fast? I don't know. But I think we can manage our way through it and use video to drive relationships for the foreseeable future. And yes, we have streaming packages. And yes, every incremental box we're putting out has a Netflix app on it. And so we're going to supply our customers with all the video they can get and use video however it develops and whoever owns it in a way that enhances the customer relationship and uses the video as an attribute of the overall product that we sell. So I guess the simple answer is I don't know what happens exactly, but that's how we're playing it.

Q - Douglas Mitchelson {BIO 1897051 <GO>}

Understood. Thanks.

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

The only piece I'd add to that is the non-programming OpEx and the CapEx for video is actually declining, and that particular piece is going to improve the economics over time. Whether it fully offsets the programming is unclear, but it's not inconsequential.

On mobile, so you're right, we're not going to provide guidance. We're not going to provide breakeven, and we hope that people will trust that when we say that it has a significant positive NPV on a standalone basis, without including the benefits to cable. And that's based on a significant amount of modeling and understanding of how those businesses works.

Comcast does not have separate economics. I actually haven't heard it, but I understand that they've spoken about what it would take for them to get to breakeven. I haven't looked at it, but given that our financial model isn't any different, because we operate under the same MVNO, my guess is it's not so dissimilar. And that's a relatively low level of penetration of the overall subscriber base that we have.

If you think about every customer service interaction that we have, whether it's a sales call or a retention call, and including into that existing call volume and flow, a mobile sale opportunity, it doesn't take you very much yield before you have the substantial wireless business that's applied to your existing base and use it as a way to drive additional cable growth. So I think on the increment, every single mobile customer that we acquire is NPV positive once you're in the business. And that's on a standalone basis without including the benefits of churn reduction or new subscriber acquisition on the cable side.

Q - Douglas Mitchelson {BIO 1897051 <GO>}

Got it. Thank you.

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

Sure.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Doug. Michelle, we'll take our last question please.

Operator

Our final question will come from Amy Yong from Macquarie. Your line is open.

Q - Amy Yong {BIO 16207054 <GO>}

Thanks. I was wondering if you could comment on pricing in general. I know that ARPU is not a focus and volume is more important for the company. But video revenue grew really nicely in the quarter, just wondering what the puts and takes are going forward now that this non-pay churn issue is over? Thanks.

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

You want to take that, Chris?

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

Yeah. Amy, if you go back and I know it was quick, but in the prepared remarks that we have – our GAAP accounting is applying a higher amount of revenue allocation out of voice into video, that doesn't mean that's what we've billed. So the video growth rate that we've reported in Q2 is inflated relative to what's on the customer bill. It's still positive. So it's about half the growth that's attached to just that revenue allocation out of voice, and the same amount is not happening into Internet from voice, which means product ARPU, product revenue is just getting less and less relevant by the quarter in terms of how it's helpful to investors and which is why we focus people on the residential revenue per customer relationship.

The piece that remains on video growth, even though we've lost video customers on a year-over-year basis, it's all come out of the limited basic or actual (56:16) expanded, which is the traditional expanded and the Stream and Choice, has actually grown year-over-year, which has higher revenue attached to it. We've also gone all-digital, which means there's higher box placement, Spectrum pricing and packaging also with higher box placement. And retrans, we've just mirrored that cost flowing through the retrans revenue line as well. So those are the big drivers on the non-revenue allocation piece for video.

But I would really caution on looking too much at the product revenue line and really focus on the number of customer relationships we have, the type of bundling that we're getting and the type of revenue per customer relationship growth that's being achieved within that context.

Q - Amy Yong {BIO 16207054 <GO>}

Got it. Thank you.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks, Amy. Michelle, thank you. That will terminate our call.

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

Thank you everyone for joining.

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

Yes, thank you. Talk to you soon.

Operator

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