Q1 2019 Earnings Call

Company Participants

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

Other Participants

- Benjamin Daniel Swinburne, Analyst
- Bryan Kraft, Analyst
- Craig Moffett, Analyst
- Jason Bazinet, Analyst
- John Christopher, Analyst
- John Hodulik, Analyst
- Jonathan Chaplin, Analyst
- Mike McCormack, Analyst
- Philip Cusick, Analyst
- Vijay Jayant, Analyst

Presentation

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 First Quarter 2019 Investor Call. (Operator Instructions)

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 First Quarter 2019 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 also our 10-Q filed this morning. We will not review those risk factors and other cautionary statements on this call. However, we encourage you to read them carefully.

Various remarks that we make on this call concerning expectations, predictions, plans and prospects constitute forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ from historical or anticipated results. Any forward-looking statements reflect management's current view only, and Charter undertakes no obligation to revise or update such statements or to make additional forward-looking statements in the future.

During the course of today's call, we will be referring to non-GAAP measures as defined and reconciled in our earnings materials. These non-GAAP measures, as defined by Charter, may not be comparable to measures with similar titles used by other companies.

Please also note that all growth rates noted on this call and in the presentation are calculated on a year-over-year basis, unless otherwise specified.

Joining me 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. The most customer-impacting and capital-intensive elements of our integration behind us, we're now focused on growing our business. We're doing that by driving high-quality subscriptions, reducing transactions and churn with high-quality products and service and maintaining and creating product superiority with value proposition that our competitors don't provide. We performed well in the first quarter, and our 3-year effort to deliver better products at better prices via a single-operating entity with a unified product marketing and service infrastructures beginning to payoff in our results.

We added over 425,000 Internet customers in the first quarter, and we created over 350,000 new customer relationships with customer growth of nearly 4% over the last 12 months. We also added 176,000 mobile lines, over 60,000 more than we added in the fourth quarter. So Spectrum Mobile is ramping quickly as expected.

Our cable EBITDA growth of 7%, combined with our falling capital intensity, yield a strong year-over-year free cash flow growth despite our investments in Spectrum Mobile and the onetime changes in working capital that Chris mentioned last quarter.

We have an excellent path in front of us for growth both in customer relationships and cash flow. Our core asset, our powerful, flexible and easy-to-upgrade network allows us to offer a data-rich wireline and wireless connectivity products to both consumers and businesses, and the demand for both speed and throughput on a network continues to increase, driven by more devices in the home and growth in IP video. That demand will continue to grow as new technologies and applications emerge. Monthly data usage by our residential Internet customers was rising rapidly, and monthly median data usage was over 200 gigabytes per customer. We look at average monthly usage for customers that don't subscribe to our traditional video product, usage climbs to over 400 gigabytes per month, which compares to an average mobile usage of well under 10 gigabytes per month.

Over 80% of our Internet customers are now in packages that deliver 100 megabits of speed or more. And 30% of our customers are on packages that deliver 200 megabits or more. We're also seeing strong demand for our Ultra product, which delivers 400 megabits, and we have gigabit service available everywhere.

Despite that, we only penetrate about 50% of our passings with our Internet product today. We view that as low relative to our potential regardless of market conditions, given the importance of our connectivity services and the way we price and package them. And the fact that we have a faster, better and cost-efficient pathway to offer multi-gigabit wireline and wireless speeds in the near future. For example, in only 14 months, we launched DOCSIS 3.1, which took our speeds up to 1 gigabit across our entire footprint at a cost of just $9 per passing, enabling 1 million -- 51 million passings to receive this service. We also have the ability, at low incremental cost, to expand our existing connectivity product set. And in coming years, through what we call 10G services as our network is bandwidth-rich, fully deployed and fully powered. Today, our Spectrum Mobile product is being sold through our MVNO agreement with Verizon, and we believe that product will help drive our connectivity, customer growth. We're currently testing the possibility to broaden the mobile capabilities of our network, using a combination of dual-SIM technology with unlicensed and potentially licensed spectrum, deployed in-home, in-business, on strand and across our 51 million passings. Any of that future development will be fully funded through a curve payback and incremental economics to our mobile business with a further goal to deliver unique and truly converged connectivity products more quickly and more efficiently than our competitors.

We're also investing in other new products. In video, we recently launched our TV Essentials package, continue to drive growth of our Spectrum Stream and Choice products. And we just launched Cloud-DVR functionality for the streaming products. Spectrum Guide is now fully rolled out to all new video connects with a set-top box in over 90% of our footprint.

We're beginning to offer in-app on-box-upgrade capabilities. We're also working on developing a security, privacy and control product to accompany our core Internet product, which we'll discuss in more detail in the coming quarters. In an enterprise, we recently launched SD-WAN products nationally, which will help drive better selling into multisite customers. So our connectivity product set and the services we sell with them continues to expand and offer a stronger penetration growth opportunities.

Over the last 2.5 years, we have deployed the tools we need to grow new customer relationships quickly. As sales channels are improving their effectiveness and selling our simple, easy-to-understand Spectrum pricing and packaging, which we modified last fall to include Spectrum Mobile. We're also seeing an increase in frictionless sales and service delivery through our online sales portals, our growing self-installation program and our self-service applications.

Our operating model and infrastructure is also designed to reduce customer transaction volume and churn, and we're seeing decline in each of those metrics. Improvements have been driven by better product and pricing, less integration activity and the better service we're delivering, whether it be from our call centers or in the field. Our customer care and field operations in-sourcing initiatives nearly complete and continues to produce higher-quality service.

Our internal IT infrastructure, which was built over the last few years, will be fully deployed by the end of this year, and our self-care platform is developing on schedule. These efforts take time to fully realize, but we're already witnessing a decline in service transactions, better quality service on the customers' own terms with first-time resolution and less churn. So we're pleased with our progress, and our operating model designed to drive continuous improvement and long-term growth in a way that works for customers, our employees, communities we serve and our shareholders.

And I'll turn it over to Chris.

Christopher L. Winfrey {BIO 16326284 <GO>}

Thanks, Tom. Turning to our results on Slide 5. Total residential and SMB customer relationships grew by 351,000 in the first quarter and by over 1 million relationships over last 12 months. Including residential and SMB, Internet grew by 428,000 in the quarter, video declined by 145,000, wireline voice declined by 99,000, and we added 176,000 higher ARPU in mobile lines. 74% of our acquired residential customers were in Spectrum pricing and packaging at the end of the first quarter. Pricing and packaging migration transactions are slowing, which, together with the completion of the network upgrades last year, means that in 2019, we're already seeing lower CPE spending, fewer service calls and meaningful churn benefits.

In residential Internet, we added a total of 398,000 customers versus 334,000 in the first quarter last year. The year-over-year improvement is primarily driven by decline in churn as our product, billing, service and collection activities improve.

Over the last 12 months, we've grown our total residential Internet customer base by 1.2 million customers or 5.1%.

Over the last year, our residential video customers declined by 2%. Similar to Internet, we benefited from the decline in total video churn year-over-year and that was offset by lower gross -- video gross additions. Despite some video loss, we expect to continue to grow our EBITDA and cash flow at healthy rates.

As part of the bundle, video drives Internet sales and reduces churn, and it remains an integral part of our business strategy for connectivity services, even if it drives less stand-alone profit over time.

So we're focused on the full profitability and returns for customer or passing, which includes video when it matters. We continue to add new services to our network and increase our revenue per passing and lower our cost per dollar revenue by adding significant value to as many customer as we can connected to our fixed network.

Wireline voice, we lost 120,000 residential customers in the quarter versus a loss of 54,000 last year, driven by lower selling following our transition to selling mobile inside the bundle and continued to fix the mobile substitution in the market generally.

Turning to mobile, as I mentioned, we added 176,000 mobile lines in the quarter, which came from the healthy mix of both unlimited and By the Gig lines. As of March 31, we now have 310,000 lines. So mobile is ramping nicely, and early results of this product launch remain promising.

Over time, we not only expect Spectrum Mobile to become a meaningful driver of connectivity sales and retention, we also expect it to be profitable on a stand-alone basis once it reaches scale, and we believe there will be opportunities to further improve the economics of our mobile business and offer unique connectivity services.

Last month, we began including the fees and taxes associated with our unlimited and By the Gig packages within our existing pricing rather than as an add-on, making our mobile products even easier to sell and service.

Our Bring Your Own Device program is expanding on schedule. And by the end of the second quarter, we expect BYOD to be launched across essentially all channels in the most popular devices.

Over the last year, we grew total residential customers by 861,000 or 3.3%. Residential revenue per customer relationship grew by 1% year-over-year, given the lower rate of SPP migration and promotional campaign roll-off and rate adjustments. And we did gross up in wireline voice and video taxes, in both revenue and expense as we did last quarter with no impact to EBITDA in the past or now. Those ARPU benefits were partly offset by a higher mix of the Internet-only customers and the higher mix of Choice and Stream within our video base.

Slide 6 shows our cable customer growth, combined with our ARPU growth, resulted in year-over-year residential revenue growth of 4.2%. Keep in mind that our cable ARPU does not reflect any mobile revenue.

Turning to commercial. Total SMB and enterprise revenue combined grew by 4.3% in the first quarter. SMB revenue grew by 5% faster than last quarter as the revenue effect from the repricing of our SMB products and legacy TWC and Bright House has slowed. Sequentially, SMB ARPU was essentially flat. And over time, we expect our SMB revenue growth rate to convert with our SMB customer relationship growth rate, and we've grown SMB customer relationships by about 10% in the last year.

Enterprise revenue was up by 3.4%. And excluding cell backhaul and NaviSite, enterprise grew by 6.1% with 11% PSU growth year-over-year. Our enterprise group is at an earlier stage of its own pricing and packaging transition, similar to what we've done in our SMB and residential businesses over the last 2 years. The process of moving customers to more competitive pricing pressures enterprise ARPU in the near term. But ultimately, the revenue growth will follow the unit growth as it's beginning to do in SMB.

First quarter advertising revenue declined by little over 3% year-over-year due to less political revenue in the quarter.

Mobile revenue totaled $140 million, with $116 million of that revenue being EIP device revenue.

So in total, consolidated first quarter revenue was up 5.1% year-over-year, with cable revenue growth of 3.8% or 4.1% when excluding advertising.

Moving to operating expenses on Slide 7. In the first quarter, total operating expenses grew by $387 million or 5.7% year-over-year. Excluding mobile, operating expenses increased by 2%. Programming increased 4.1% year-over-year as we had a small programming benefit in the first quarter. And as I mentioned last quarter, a mid-single-digit growth rate is probably a good base line for 2019 programming cost growth.

Regulatory, connectivity and produced content grew by 5%, driven by the same voice and video tax and fee gross up in revenue, video CPE devices sold to customers partly offset by a year-over-year decline in content cost, given fewer Lakers games in the first quarter of 2019 versus the first quarter of 2018.

Cost to service customers declined by 1.7% year-over-year compared to 3.8% customer relationship growth. And even when excluding some bad debt improvement, cost to service customers were down slightly year-over-year. So we're meaningfully lowering our per relationship service cost, which is core to our strategy. Whether it's through in-sourcing, training, business process and system changes, these are all series of small improvements, which, together with our pricing and packaging and promotion structure, churn rate improvements, which take time, but ultimately drive momentum.

Cable marketing expenses declined by 2% year-over-year, and other cable expenses were up 4.8% driven by insurance and software cost.

Mobile expenses totaled $260 million and were comprised of mobile device cost tied to the EIP device revenue, market launch cost and operating expenses to stand up and operate the business, including our own personnel and overhead cost and/or portion of the JV with Comcast.

Cable adjusted EBITDA grew by 7% in the first quarter. And when including the mobile EBITDA startup loss of $120 million, total adjusted EBITDA grew by 4.2%.

As we look to 2019, annualizing our fourth quarter 2018 mobile EBITDA loss is a good starting place for estimating our 2019 mobile EBITDA losses, subject to the same assumptions we laid out on the last call.

Turning to net income on Slide 8. We generated $253 million of net income to Charter shareholders in the first quarter versus $168 million last year. The year-over-year increase was primarily driven by higher adjusted EBITDA, lower depreciation and amortization expense and lower merger and restructuring charges that was partly offset by higher GAAP tax expense and noncash write-down of a legacy TWC investment and higher interest expense.

Turning to Slide 9. Capital expenditures totaled just under $1.7 billion in the first quarter, with our cable CapEx declining by about $600 million year-over-year. That was driven by lower CPE with less SPP migration, and as we finished all-digital last quarter, we also had lower scalable infrastructure primarily driven by the completion of our DOCSIS 3.1 upgrade in the fourth quarter and lower support spending within cable. That was partly offset by higher spend on line extensions as we continue to build out and fulfill our merger conditions, and we spent $88 million on mobile-related CapEx this quarter, which is mostly accounted for in support capital and was driven by retail -- our retail footprint upgrades for mobile and software, some of which is related to our JV with Comcast.

Annualizing our fourth quarter 2018 mobile CapEx figures remain a simple way to estimate our full year 2019 mobile CapEx. We expect mobile CapEx for the launch of our MVNO service will decline following the upgrade of our retail footprint.

As a reminder, for the full year 2019, our internal plan calls for roughly $7 billion of total cable CapEx in 2019 despite the usual first quarter seasonality. If we find new high-ROI projects during the course of the year or that accelerated spend on existing projects will drive faster growth, we would continue to do so. An example of mobile would be a clear payback on moving traffic on to our own network. And while that's probably not a 2019 event, it is something we'll evaluate as our mobile network develops capabilities, as Tom outlined.

Slide 10 shows we generated $645 million of consolidated free cash flow in this quarter, including about $290 million of investment in a launch of mobile. Excluding mobile, we generated $936 million of cable free cash flow, up nearly $1 billion versus last year's first quarter. The year-over-year growth was driven by higher adjusted EBITDA and lower cable CapEx. And as expected, we had a negative change in cable working capital during the first quarter primarily due to a meaningful decline in our cable CapEx accruals and payables.

Although I expect our full year change in cable working capital would be negative primarily because of Q1 as we move through the year, the cable business should exhibit more typical quarterly working capital seasonality. And as we move to 2020, I would expect changes in our cable working capital to be neutral to be beneficial to our full year free cash flow results.

On the mobile side, we continue to add mobile customers, which drive handset-related working capital needs, this should accelerate growth rates and we should expect to see that trend continue for the foreseeable future.

On the balance sheet, we finished the quarter with $73.4 billion in debt principal. Our current run rate annualized cash interest, including the impact of repaying $2 billion of TWC 8.25% notes on April 1, is now $3.8 billion.

As at the end of the first quarter, our net debt to last 12 months adjusted EBITDA was 4.43x. We intend to stay at or below the high end of our 4 to 4.5x leverage range, and we include the upfront investment of mobile to be more conservative than looking at cable-only leverage. Net cable-only leverage was 4.34x at the end of Q1, and it's declining.

We have strong visibility on EBITDA growth and accelerating cash flow growth, tax assets, long-dated maturities and attractive weighted average cost of debt and we naturally delever as much as half turn per year absent buybacks. All of that suggest our current leverage is prudent. And if we see a permanent increase in our refinancing costs, a change in business outlook or investment opportunities, we can reduce the total leverage quickly and efficiently.

During the quarter, we also repurchased 2.9 million Charter shares and Charter Holdings common units totaling about $1 billion at an average price of $330 per share. And since September of 2016, we repurchased 20% of Charter's equity at an average price of $328 per share.

Good operating model, network capabilities, now in the future and our balance sheet strategy, all work together over long periods of time, and we expect our results to reflect a growing infrastructure assets with the lot of ancillary products to use for and sell on top of our core connectivity services with good value and service to our customers to grow cash flow with tax advantage, lowered equity returns.

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

Questions And Answers

Operator

(Operator Instructions) Your first question comes from Vijay Jayant from Evercore.

Q - Vijay Jayant {BIO 1526830 <GO>}

Thanks.Tom, you've talked about the strategic interest in possibly getting some mid-band spectrum, and you talked about trying to get more mobile traffic on your network. Can you just talk about what the opportunities are and what the investment opportunity can be? And I don't think in 2019 event per se, but anything on that front would be helpful. And then very quickly for Chris. You talked about the shift in working capital? Is that something we should start seeing in 2Q, given this is a massive use of working capital in 1Q and going forward becoming a tailwind?

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

As I said in my remarks, it probably isn't any time this year. We are doing experiments with the capability of moving traffic in an efficient way where it's economically viable to do so, which means that whatever capital investment we would make would be offset by a reduction in MVNO costs and, therefore, would be a higher return when we would do -- will we -- we would get by just expanding -- MVNO costs. So it's really at least by build analysis, and -- so from a technical point of view, there are multiple spectrum opportunities, some of which are free and some of which are licensed. CBRS is what we're experimenting in and that will be available to us at no cost, at least part of it will be. And we also continue to develop WiFi and WiFi capabilities. And so there are mix of WiFi licensed and unlicensed opportunities, and they can be used in different locations. We look at really sort of 3 physical infrastructure zones, one is the home, one is on the physical plant and the other is potentially macro, tower-type, Spectrum capabilities. We think that the most significant opportunity may be on our strand, but we haven't completed any of the experiments yet. And we haven't decided to deploy any capital, but that's the opportunity.

Vijay, on the working capital question. Taking a step back and a growing cable business it has longer be DPO than DSO, should actually contribute cash through working capital. And so since we're already growing cable business, we expect over the longer term and full year cycles to actually generate cash flow from working capital. That wasn't the case in Q1 as we had a big step down in our capital expenditure, a big step down in our payables and accruals related to that. And so you had a onetime hit associated with unwinding our CapEx cycle. We also had that onetime benefit on the wind up. If you look back in 2016 and 2017, we actually generated $2 billion of cash flow from working capital, some of which was permanent due to balance sheet management practices, some of which it was simply just by stepping up the level of capital expenditures through the integration.

But now that returns through that, it doesn't mean that quarters will have seasonality. In the due, there is large seasonality in cable inside the quarters, but the seasonality will start to look a little bit more normal like it has in the past, beginning in Q2. We're still making some minor changes inside the business that could have a small impact. I'll give you one example. In the business of this size, we're collecting well over $100 million a day from customer receipts. So how you end the quarter, whether it's on a weekend or not can have a big impact on 1 year or for another. But all that aside, the normal seasonality should start to look the same really from Q2 going forward. And when you get into 2020, the cable side of the business, working capital to the extent we're growing should actually be neutral or is not actually creating cash flow to free cash flow.

That doesn't include mobile. And mobile is a function of how faster you're growing your devices and the amount of payments that you're receiving on these devices that we're financing. It's also a function of how much BYOD that you're taking on. Clearly, Bring Your Own Device not only makes it easier for consumers, it makes it easier to point of sale. Then it also reduces the load on us to have to go fetch the device for that customer. And so we're pretty excited about BYOD being introduced. But if you're stepping up the amount of gross additions and some of that is, including EIP-type device financing, there is going to be a short-term pressure on working capital as it relates to mobile. It's not a question of value to get the money back. Over time, it's just a question of timing.

Q - Vijay Jayant {BIO 1526830 <GO>}

Thank you, both.

A - Stefan Anninger {BIO 15867691 <GO>}

Operator, we'll take our next question please.

Operator

Your next question comes from Craig Moffett from MoffettNathanson.

Q - Craig Moffett {BIO 5987555 <GO>}

Two questions, if I could. First, just -- I just want to clarify your comment earlier that the current wireless -- or the wireless business will be profitable once it reaches scale. Should we assume that means under the current deal? Or that only given the some of the network enhancements and moving traffic on to your own network that you've been describing in the last couple of minutes? And then if you can also just talk about the longer-term margin and CapEx trajectory for the business, Chris, I think with a CapEx guidance for this year, obviously being quite a bit lower than what people might have thought a few months ago and with margins continuing to expand, where do you think those can go longer term?

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

So the comments that we are making about the ability to improve the economics of the mobile business really would be opportunities. And we expect Spectrum Mobile to be profitable on a stand-alone basis without considering any of the benefits of the cable and under the existing arrangement that we have with Verizon, which we quite like. We expect that all to be profitable and to add -- on the stand-alone basis and to add value to cable. So some of the opportunities that we've been talking about with the opportunities to make it even more profitable, maybe even faster and to create a unique product out there that doesn't exist today. And as Tom mentioned, we're travelling all of that. We've got trials all across the country with different versions of Spectrum, fixed, mobile, et cetera, and we're working with dual-SIM. That -- it's probably not a 2019 event. So when I talk about profitability of the business, this would be the agreement we have, the relationship we have. It's working extremely well. We expect mobile to be profitable on a stand-alone basis with or without any of those opportunities.

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

And profitable to Verizon as well.

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

Yes. And we think it's very accretive to Verizon over time as well. As it relates to longer-term CapEx guidance, we haven't given any. And we're not known for doing that either. But what I would tell you is that the capital expenditure for cable as a percentage of revenue, we don't see anything on the horizon that doesn't cause it to continue to decline in the capital intensity as a percentage of revenue. All that comes about because the CPE environment's gotten much more efficient, meaning we need less of it, particularly on video. And a lot of that is because the integration capital is now largely behind us.

And because the video product both has lower set-up boxes for traditional video household and we have streaming products and we just populated in our entire base of customers with brand-new CPE that has boxes capabilities, means that the intensity of that is going to decline. So could it get into the low double digits, for sure? And I think that's what our plans internally contemplate. I will tell you, Craig, you think about this a lot. Cable's had the ability to continue to invent new products. So we'll work our way down on cable intensity, but there's probably revenue streams out there that nobody is modeling today that nobody's thought of today that aren't in our own business plans today. And that's been the opportunity in cable really for decades, and I don't think that goes away either.

Q - Craig Moffett {BIO 5987555 <GO>}

And just want a clarification. Just -- is this probably the peak spending year for wireless? Or at least the peak -- the year for peak losses? Or is that more likely to be 2020?

The losses -- it's a trickier question because it depends on how fast you're growing. And so to the extent that you're growing fast in any subscription business that's coming from standing start, you're going to have more EBITDA losses. So I don't want to sit here today and forecast, which I could from an economic standpoint. If we're at a standstill, we were growing, then the answer to your question would be, yes, 2020 would be a better year, but we actually have to grow faster.

And so that may put more sales and marketing pressure for -- on stock and the ability to go acquire customers. As it relates to CapEx, the bulk of the capital expenditure should be through this year and maybe a little bit bleeding into next year with kind of short retail footprint. That's our base plan. That's the agreement that we have with Verizon. To the extent there are opportunities to build on wireless to -- had a clear payback and ROI to expand our fixed line network, our Wi-Fi network to move into small cells, to the extent that comes about, what we've articulated really clear, there may be an investment if we end up doing that, but it will tied an ROI and payback as well as just on the cost side. And then to the extent you've got a unique product, clearly, you have revenue synergies from that as well.

That's helpful. Thank you.

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

We'll take our next question, Michelle.

Operator

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

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

Hey, John.

Operator

Mr. Moffett, your line is open.

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

And you give us John Hodulik. But maybe if John is not there, maybe we move on to the next one and come back to John please.

Next we move on -- we'll move to the next question, please, Michelle.

Operator

So your next question will come from Jonathan Chaplin from New Street. Your line is open.

Q - Jonathan Chaplin {BIO 4279061 <GO>}

So I think the residential results really speak for themselves. So the acceleration we're seeing in broadband, better-than-expected EBITDA and the context you gave around usage for non-video subs, I think really helps for the wireless substitution and the fixed wireless broadband thread into context for people. I'd like to just focus a little bit more on the enterprise business. So because I think you said that subscribers in SME growing at 10% and revenue growth should converge with subscriber growth. Is that 10% subscriber growth sustainable? Is that way you expect revenue growth to accelerate towards? And how sort of quickly over the course of this year should we see that acceleration happen? And then can enterprise achieve similar kinds of growth profile as SME? And I guess finally on the enterprise business, the incremental margins for that business similar to the residential business or is there more cost associated with it?

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

There's a lot in that, Jon. SMB, clearly, our goal is to continue to grow with those type of rate for SMB. As the business gets larger, the lot percentage has been, it's a little bit harder to do, but whether it's high single digit or low double digit, I think our view is that the SMB market is under penetrated by us and that we can bring a lot of value there.

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

It's clearly under penetrated relative to residential too. And therefore we would think this has a number of years of growth in front of it.

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

Agreed. And in terms of the timing of when the revenue growth rate. I mean, you've got a pretty clear graph now. If you take a look at the year-over-year growth rates, when it bottoms out, how it's accelerating. These are -- unlike the residential business, it doesn't move as fast and migrate as fast as the residential business in the business space, but it's happening and the revenue growth is accelerating. Do we think that it will be all the way back up by the end of this year to where the revenue growth rate is the same as our unit growth rate, probably not, but probably closer? And then as you look into 2020, we may have

starts to look more like your customer growth rate and maybe pricing opportunities are slowing in that space over time. Enterprise is another extension of that achieving longer to work your way through that. And so we're -- I don't know if we're at the trough or punching the trough right now on enterprise, but we think it will go through a similar cycle, those customers and longer-term contracts. And then in the -- and that business is growing at 11% PSU growth rate or actual fiber to core that business, fiber connectivity is growing at a much faster pace than even that 11%.

Your question about the economics. The SMB economics, when you think about a ROI or payback model looks a lot like the residential space. It's a high-transaction business. It just has a higher ARPUs and it has lower churn rate but it has a lower upfront cost, all of which means your payback is kind of inflated on every single one of the revenue cost and recurring in upfront metrics. Enterprise, highly accretive business and it has a multiyear payback because of the upfront construction cost in many cases to the extent you're having to put in brand-new fiber. And -- but it has a much higher operating margin than.

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

Higher capital.

Higher, yes.

Higher capital, higher operating margin.

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

That's right. And so what that means is that you end up with a multiyear payback as opposed to 1 or 18 months payback. But as a result, you end up with physical network infrastructure going into a building that allows the acquisition of the next customer to be acquired at a higher ROI and a better payback.

Q - Jonathan Chaplin {BIO 4279061 <GO>}

That's great. Thank you.

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

Thanks, Jonathan. Michelle, let's take our next question, please.

Operator

I'm going to try to open the line if John Hodulik again. your line is open.

Q - John Hodulik {BIO 1540944 <GO>}

Can you guys hear me?

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

Yes.

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

Yes, John.

Q - John Christopher {BIO 15913228 <GO>}

Okay, great. May be another question on the cost side here. You guys have some guidance out there for programming costs growth. On the non-programming cost growth side, you've seen some declines. Can that -- what -- can that continue to come down? And is there any sort of granularity you can provide us on some of the opportunities? You talked about moving more towards digital transition, anything else you can give us on that line item? And then although it's small, I notice that NaviSite is providing a little bit of headwind in terms of revenue growth. A lot of other carriers have sold their data center operations. Any chance that you guys could look to monetize that asset?

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

In our cost to service, you mentioned the -- well, we have several things going on. One is lower bad debt. And I talked about that in the prepared marks. The second is that the integration is -- customer-facing integration is behind us. Our calls are coming down, truck rolls are coming down, churn is coming down. And we think there is a still early innings in terms of the momentum that we're creating there. And Tom's often talked about our move towards self-installation and online service and the amount of cost that, that can take out of the business. So I think there is a long runway for continued productivity. And the productivity -- when I say productivity, keep in mind that our customer relationship growth rate is pretty much 4%.

And to the extent that you have cost to service customer is going down by 1.7%, it's close to 6% of productivity despite the fact that you have year-over-year wage increases. It's very large in that size of business. And can I continue with that same rate? I don't know. But I think it's going to continue to get better and better on it per customer relationship basis. And the only caveat I give to that is we have sales and marketing cost, which we suffered. Clearly, we have accelerated growth to reduce the sales and marketing start to move as well. But when you have brand-new customers, the cost to provision for -- to move those over that certainly costs to service. To the -- so to the extent you have a new higher base of newly acquired customers in a growth environment that has a negative impact on your cost to serve. So you're going to see some of that cost to serve move based on our growth adds acceleration to the extent of taking place. Your second question was around enterprise. We look at all different opportunities, what to do the business. NaviSite is an asset that was acquired by TWC. I don't know, 5, 6 years ago at least. But we don't really comment on M&A as it relates to the different assets that we have. So.

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

Just to add small lines in cost to serve. I do think it's a bigger opportunity than we might have thought a few years ago. And the result -- we only had a plan to have a lower cost to serve by improving wages, improving the quality of every service transaction we do, improving the skills of the people and the tools and the equipment that they have, so that our customer life was extended through customer satisfaction. And that itself reduces activity in the business, lower churn business cost less to operate than higher churn business and the way to get there is actually it's been more per transaction but make the transaction higher-quality transaction.

And so our transaction volume was rapidly declining and it's declining because customer satisfaction's improved but also because we have less service activity because we operate better, which in itself is virtuous and that it also improves satisfaction. So that was always in our thinking and in our planning and why we do the integration the way we did it? But we're getting a digital good guide as well in terms of self-service capabilities, our ability to direct ship customers' equipment, have themselves install that equipment, self-division that equipment. And all of that upside from a digital economy perspective is really sort of fortuitous for us in -- since that it wasn't really in our operating planning model.

Operator

Your next question comes from Benjamin Ben from Morgan Stanley. Your Line is open.

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

I have a question for Tom on broadband growth and a question for Chris. Tom, you guys are doing I think you said 5% broadband customer growth in the last 12 months. You called out churn being a driver of that growth. When you look out, can you talk about the runway you see ahead of the business to keep that growth rate going or at least to continue to drive down churn from where you are today? And you called out something, I think you referred to as 10G services.

I think I got that right, tied to connectivity. Since you mentioned in your prepared, I wanted to see if you have more color on product's roadmap. And then just for Chris, more near term, you're lapping last year's billing systems stuff, which I think impacted both customer adds and bad debt. Can you just help remind us how Q2 compared to Q1 last year is we can think about the impact in the quarter we just saw versus what's coming up?

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

So Ben, I'll do the 10G question, and Chris can talk about our year-over-year comps. The 10G notion is really connected to what we just accomplished in going to 1-gig. And it's the capability of a relatively inexpensive upgrade to our physical infrastructure and to provide a whole new level of service. And 10G is a set of specification that we've actually completed at CableLabs for a whole traditional cable-TV broadband industry that creates a technical pathway to upgrade plant at reasonable costs to 10-gig symmetrical service. And it will ultimately allow us to have 10-gig wireless service. In fact, all the devices we anticipate in the future being connected to our network will most likely be wireless products.

And so 10G is a set of specification to take us to a new platform. And we can build that platform incrementally through time going to 3G or 5G or 10G. And actually, a whole new set of spectrum being developed to go to 25-gig capability. And we've been able to expand realistically through testing and specifications, the capacity to our network by 4x. So we're 750-megahertz capability platforms today. But we can see ourselves going to 3-gigabit capability in terms of breadth spectrum available in our infrastructure. So it's really designed as a notion to show that we have a great infrastructure platform that we can build new infrastructure platform capabilities on top of what we already have at low incremental costs and creative industry.

I don't know who needs 10-gig symmetrical today, but that probably means that we have very high compute, low latency, high capacity network and one of the services that require that gaining, but new forms of entertainment, they're very immersive. And new forms of education and medicine are very immersive. And we think we are the platform of choice for the development of those future products.

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

And just on churn, Tom. Any comment on runway to keeping driving that down and keep this level of broadband growth going?

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

Yes. Well, yes. We still think we're under penetrated both in residential and in commercial. And we think that there's a lot of opportunity for growth with superior products and high-quality products and superior service and pricing and packaging of those products. And our primary objective is to grow market share through quality. And we think there's lots of upside.

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

Ben, As I said, the longer-term outlook and clearly, if you take a look at that results from past couple of quarters, we have momentum and we had a strong quarter in customer relationship and Internet net adds, they improved meaningfully year-over-year. In part that was driven, as you mentioned, by the high level of integration activity and disruption that we had and much of which we planned for in 2008. So in a shorter term, our goal is to accelerate relationship and financial growth in 2019.

But as you think about the rest of the year, keep in mind that the 2018 quarters were less impacted by integration activity as the year progressed. And so to your point, does that mean it becomes a slightly more difficult comp over the year, yes. But we also have the benefit of the changes that we've made, the momentum that we're creating that clearly, Q1 we had a strong quarter. And our goal is to continue to get better throughout the year and longer term for all the reasons that Tom mentioned.

Operator

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

Q - Bryan Kraft {BIO 20667157 <GO>}

You obviously had a strong first quarter as far as broadband and sub growth. Can you just comment on the competitive environment broadly? Are you seeing any change in competitive behavior or promotional intensity from any of your large competitors or things pretty much stable? And then I also just wanted to ask a follow-up on margins. Excluding mobile, cable EBITDA margin improved by about 110 basis points year-over-year. Was there anything in the quarter that was temporary or unusual in this quarter's numbers relative to how you're thinking about the rest of the year?

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

So Bryan, I think that the competitive environment hasn't changed significantly. This year, it's still very competitive. And what we're doing is improving our own products and way we operate. And I think change in our growth rate is primarily because of things we're doing not because of the way the marketplace is behaving.

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

And on margin, there's seasonality each year inside of the cable business based on the quarter -- quarterly connects. So if you think about Q2 as the heavy disconnect quarter or Q3 as the heavy connect quarter, both of those have been impacting margin, but that's the same year-over-year. The only thing that was unique inside of Q1 this year, we had, I mentioned, as you think about future quarters' programming costs, we had a small benefit. It wasn't particularly large, but a small benefit in programming.

And we -- the comments I made about our expectations for programming for this year would be in mid-single digits, as opposed to that 4%. It's pretty small difference. But that's the only thing that was inside the quarter that I would talk right now respect. The business is getting more efficient for all the reasons that we talked about earlier on the cost to serve, primarily.

Q - Bryan Kraft {BIO 20667157 <GO>}

Okay. Thanks very much.

A - Stefan Anninger {BIO 15867691 <GO>}

Michelle, we'll take our next question please.

Operator

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

Q - Philip Cusick {BIO 5507514 <GO>}

HI, guys.I guess a little bit of a follow-up. Obviously, the broadband results were great, but the video's sub numbers softer year-over-year. And despite the TV Essentials launch, you mentioned video gross adds were down year-over-year. Should we see this as the company deemphasizing video in some way? Or has there been a shift away from the video broadband Double Play that you were focused on in the fourth quarter?

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

So video business has its challenges. What we've talked about a lot over the last several years, and we've said we sort off financially different to what's going on in the video business. But we still believe that video is an attractive product that we should sell it and it should be integral to our product and help drive our core relationships. All the trends in video that have been going on continue to go on. And the issues that are knocking video growth down are the price of the big bundle and the security of the big bundle. And it's easy to get with password sharing. And we still think high priced easy to get for free service is a hard thing to sell off. And that we continue to develop new video products, and we're trying to serve the whole marketplace and be available as a video provider with a high quality integrated video service for all the customers that want to buy that service from us.

So where we stand in the continuum and what our operational issues are as we begin to emphasize mobile and our packaging. Yes, those things have small effects on the general performance of the company and they probably do on our video game. But the macro trends I think are that video is going to decline and the question is how fast. And I think with satellite declining at the rate it is, but there are opportunities for us to convert those customers into our customers along with making them our broadband customers. And so we still think that video is a driver for us in terms of customer creation, but it's prioritized in our internal operational tactics appropriately based on the reasons I just said.

Q - Philip Cusick {BIO 5507514 <GO>}

So as you sell a product to new customer obviously, broadband first. And then now mobile seems to have taken some precedent in that selling process versus video?

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

I wouldn't say it takes a precedent but it's a -- it -- mobile has its own -- and we wish to ramping mobile into our operation. And we're changing the nature of our Triple Play. And the price value relationship of our Triple Play as a result of mobile and it impacts the overall performance of the individual components. But video is important to us, and mobile is important to us. But they're important really as drivers of the whole relationship. And so I wouldn't prioritize one over the other.

Q - Philip Cusick {BIO 5507514 <GO>}

Got it. Thanks.

Thanks, Phil. Mitchell take our next question please.

Operator

Your next question comes from Mike McCormack from Guggenheim Partners. Your line is open.

Q - Mike McCormack {BIO 5717983 <GO>}

Maybe just a quick comment. I know you said taxes and fees are not included in the mobile plans, how much would impact that have on profitability? And I guess, Chris, if you can just sort of work through whether it's been accounted for? I presume it's just a contra-revenue line. And then secondly, just on the buyback, is this pace thing in 1Q is something we should expect to continue for the balance of the year?

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

Sorry, what was the second question that you had?

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

Buyback pace.

Q - Mike McCormack {BIO 5717983 <GO>}

With regards to buyback pacing, if 1Q is the correct run rate?

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

Right. So on the profitability, always taxes and fees was something that had always been our objective here. So it was always part of the plan. It wasn't really new idea. It just fix it while the operation to get implemented. So if you think about our pricing at $14 per gig and $45 per Unlimited, it had always been in our thinking that, that would be ultimately rolled out to both existing and new customers as outlined. So it's always been inside our financial plans. It is reflected similar to our voice product -- or fixed line voice, wireline voice that we have today, runs with the similar type of strategy as does all of our -- for the most part, our of other products as well as to accounted as a contra revenue. And if you think about mobile revenue today. In the quarter, we had $140 million of total mobile revenue, of which $116 million was device revenue. So from a run rate impact of what we've just implemented to the existing base subscribers, not particularly material. And on a going-forward basis, it was always in our plans. And we think it's actually helpful to distinguish ourselves in the marketplace relative to others.

On the buybacks. We don't give guidance on buybacks. And the reason we don't give guidance on buybacks is because we don't want to put a number out there that certain ways becomes an artificial target. And then to the extent an opportunity comes along that say better investment profile to use that cash because that turn a lot of the just (inaudible) by the guidance that you gave yourself is a tough place to be in. We don't think it's the most value-enhancing way for creating value for shareholders. But I would tell you, inside the first quarter, if you think about the mobile investment that we're making as well as more importantly the working capital that we had in the cable side of the business in Q1 and then the overall leverage target guidance that we've provided, it's really those factors that drove the amount of buybacks that we did inside the first quarter and the lack of better place for the capital in that particular quarter.

Q - Mike McCormack {BIO 5717983 <GO>}

Make sense. Thanks Chris.

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

Yes.

A - Stefan Anninger {BIO 15867691 <GO>}

Thanks Mike. Michelle we'll take our last question please.

Operator

Your last question for today is from Jason Bazinet from Citi. Your line is open.

Q - Jason Bazinet {BIO 4013756 <GO>}

This is maybe a little bit of strange question given your investment in active video on what you've just completed on the box side. But do you mind just updating us on sort of your thinking about licensing X1? Is that still something that is unappealing to you? And if so, do you mind just reminding us your philosophy behind that?

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

Well, Jason, it's -- we're down the road with our own user interface. But we have a good relationship with Comcast, and we've had discussions with them about licensing their X1 platform and their new IP video platform. And if we can make that the best platform for us, we'd certainly be willing to do that. And we think they'd be a great provider. To date, we haven't. And we like our own UI, and we like having our ability to change that UI and -- at the pace we wanted to change it. And to make it reflect our marketing strategy and consistent -- to the extent, we're different from Comcast or anyone else out there. We want to be able to continue to have that capability. So if we can sort of check on the boxes in terms of having complete flexibility and low cost, we could become a vendor of Comcast in terms of our platform. Today, we haven't been able to do that.

Q - Jason Bazinet {BIO 4013756 <GO>}

Understood. So it's more about flexibility. All right.

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

Thanks Jason. Michelle, that ends our call.

Operator

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

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

Thank you very much. Thanks, everyone.