

Operator

Welcome to the AT&T Fourth Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, there will be a question-and-answer session. Instructions will be given at that time. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host Michael Viola, Senior Vice President of Investor Relations. Please, go ahead.

Michael Viola

Thank you, and good morning, everyone. Welcome to our fourth quarter conference call. I'm Mike Viola, Head of Investor Relations for AT&T. And joining me on the call today is Randall Stephenson, AT&T's Chairman and CEO; John Stankey, Chief Operating Officer for AT&T; and John Stephens, AT&T's Chief Financial Officer.

Randall will begin the call with a brief overview of the 2019 accomplishments and a look at our three-year plans. John Stephens will then discuss fourth quarter results and then John Stankey will walk you through key areas of our 2020 operating plan. John Stephens will then close the presentation with an update on our capital allocation plan and 2020 financial guidance. Then we'll take your questions.

Before I begin, I want to call your attention to our safe harbor statement, which says that, some of our comments today may be forward-looking and as such, they're subject to risks and uncertainties. Results may differ materially and additional information is available on the Investor Relations website. I also want to remind you that we're in the quiet period for the FCC Spectrum Auction 103, so we cannot address any questions about that today. As always, our earnings materials are available on the Investor Relations page of the AT&T website. That includes our news release, investor briefing, 8-K and other associated schedules.

And so, with that, I'm going to turn the call over to Randall Stephenson. Randall?

Randall Stephenson

Thanks, Mike. I want to start on slide three to close out 2019. And coming into 2019, we laid out a detailed plan for the year and that plan was the series of specific steps necessary to exit 2019 on a path of sustained growth. A simple summary on slide three is that we met or exceeded every single one of those objectives and the road map is set for the next three years.

I told you that our top priority for 2019 was to reduce our debt and exit the year at around 2.5 times debt to EBITDA, done. We have now reduced net debt by about \$30 billion since we closed Time Warner. And at the end of 2019, our net debt to adjusted EBITDA was about 2.5 times.

We gave you the formula for exactly what it would take to get to this debt level. First, we would need to generate \$26 billion of free cash flow, done. We exceeded that handily, generating a record \$29 billion for the year. Second, we would need to monetize non-strategic assets and generate \$6 billion to \$8 billion of cash, done. We actually generated nearly \$18 billion, more than double our target. And we've already announced an additional \$2 billion, which will close in 2020.

On adjusted EPS, we came in right on plan, low single-digit growth. At WarnerMedia, we achieved the 2019 merger synergies and we're preparing to launch HBO Max in May. Growing wireless service revenues was critical and those revenues were up nearly 2% for the full year.

We stabilized Entertainment Group EBITDA and brought in our capital investment right on plan. And after sustained investment in our network, AT&T exited 2019 with the best and fastest wireless network in the United States. Our 5G network covers 50 million people today and we expect to have nationwide 5G coverage in the second quarter. As we look forward, our 2019 performance positions us well for the next three years.

Our plan is very straightforward and we've laid it out for you on slide four. We see revenue growth every year and expect a 1% to 2% three-year CAGR through 2022. By 2022, adjusted EBITDA margins expand by 200 basis points, adjusted EBITDA grows by about \$6 billion, free cash flow is between \$30 billion and \$32 billion and adjusted EPS grows to between \$4.50 and \$4.80.

This is a plan that generates a lot of cash over the next three years. And the Board has developed a very thoughtful capital allocation approach that will maintain a solid balance sheet and drive shareholder value. First, we'll continue to invest aggressively and at top-tier levels into our core businesses. We expect to invest \$20 billion in 2020.

Leading in 5G is critical for AT&T and we're not slowing down. We're more than 75% complete on our FirstNet build and that will continue. And we're continuing to deploy fiber. In terms of our capital structure, over the last 18 months we've retired the lion's share of the debt we issued to acquire Time Warner. And we'll continue to pay down debt, but at a much slower pace. Our cash will be focused over the next three years on retiring the shares we issued to acquire Time Warner. By the end of 2022, we will have retired

100% of the debt and 70% of the shares from our Time Warner transaction. In fact, we retired 56 million of these shares in 2019.

We also plan to retire about 100 million more in the first quarter of this year to a \$4 billion accelerated share repurchase agreement. By 2022, our leverage target is a very comfortable net debt to adjusted EBITDA ratio of 2.0 to 2.25 times. You can also expect us to continue streamlining our portfolio as we monetize additional assets of \$5 billion to \$10 billion this year. And as I said earlier, we've already executed agreements that will generate \$2 billion this year.

John Stephens will cover the specific steps in the plan later. But first, he's going to cover our fourth quarter results. So I'll turn it over to you now John.

John Stephens

Thanks, Randall. Let me begin with the financial summary on slide 6. As Randall mentioned, we hit or exceeded all our 2019 targets. Let's take a closer look. We grew earnings. Adjusted EPS was \$0.89, up 3.5% for the quarter and up 1.4% for the full year. Cash from operations came in strong at \$11.9 billion for the quarter and \$48.7 billion for the year. Free cash flow was a record \$29 billion for the full-year, up 30%.

The addition of WarnerMedia made an impact as did adding their receivables to our securitization efforts. Our ability to generate cash continues to provide a strong foundation for our capital allocation plan. We continue to aggressively invest. CapEx was nearly \$20 billion for the full year and total gross capital investment was \$23.7 billion, when you include our investments in FirstNet and other vendor payments.

And without the impact of foreign exchange and forgone licensing revenue in advance of our HBO Max launch, fourth quarter and full year revenues would have been \$48 billion and about \$184 billion, representing growth in both the quarter and the year. Even with these items, operating income margins were stable in the quarter and up 70 basis points for the year. All in all, a very good year as we hit our 2019 targets.

Let's now look at our segment operating results starting with our Communications segment on slide 7. In our Communications segment, mobility continues to build momentum and deliver solid results. Service revenue grew by about 2% in the quarter and for the year. EBITDA grew both in the quarter and for the year. And EBITDA margins expanded by 40 basis points for the year, while service margins were stable even with a heavily promotional fourth quarter.

Postpaid phone growth was solid adding 229,000 in the quarter. For the year, we had about one million phone net adds both postpaid and prepaid. This strong performance was driven by our industry-leading network and came even while postpaid phone churn was up as competitors ramped up promotional efforts. You should note total churn postpaid and prepaid combined improved year-over-year by 12 basis points.

As Randall mentioned, our Entertainment Group hit its full year target of EBITDA stability. Long-term customer value continues to be our focus as we head into 2020. That focus has helped drive growth in video and IP broadband ARPU's. AT&T Fiber continues to grow adding nearly 200,000 customers. That brings us to nearly four million AT&T Fiber customers and we have lots of room left to grow.

Premium video net losses improved sequentially by more than 200,000 subscribers, but video losses continue to impact our broadband numbers, especially our bundled customers. Our new simplified video offerings position us for the long term and our subscriber trends are improving.

Let's turn to Business Wireline. The trends in Business Wireline continued to improve. Revenues grew sequentially and were down just 1.7% year-over-year. And when you include wireless, Business Solutions grew 1.1%. EBITDA was relatively steady in the quarter and EBITDA margins were up 40 basis points.

Let's move to WarnerMedia and Latin America results, which are on slide 8. WarnerMedia had a great quarter when you consider the decision to forego content licensing revenue. Subscriber revenue growth at both Turner and HBO combined with lower film and television production cost at Warner Bros. helped to offset that pressure.

We made the strategic decision to give HBO Max exclusive streaming rights for top programs including Friends, Big Bang Theory and other popular shows. In the past, we would have sold these externally.

Looking at the impact on the fourth quarter, WarnerMedia revenues would have grown by about 10% if these shows would have been sold. In fact that 10% organic growth would represent WarnerMedia's best growth rate in three years. And EBITDA would have increased by about \$300 million or about 11%. Obviously this has an upfront cost for us, but we see this as an investment that makes HBO Max even stronger and will pay off over the long-term.

The big news in our Latin American operations is Mexico turning EBITDA positive in the quarter. The team has done an excellent job of reducing costs and growing revenue in a challenging environment.

Fourth quarter Mexico EBITDA improved nearly \$200 million year-over-year and improved by more than \$300 million for the full year. We continue to press for further gains.

A new wholesale agreement with Telefónica will add to both revenues and EBITDA. Going forward we expect continued improvement. Vrio continues to work against economic and foreign exchange headwinds. But even in this environment, it continues to be profitable and generate positive cash flows.

Now, let me turn it over to John Stankey to cover our 2020 operating plan and then I'll come back and discuss a capital allocation update. John?

John Stankey

Thanks, John, and good morning, everyone. Starting on slide 10. These are the four key areas of our 2020 operating plan where we'll be focused in executing to drive our performance.

I'll go into some detail on each of these over the next few minutes but I'll give you the headlines first. Number one is continuing our momentum in mobility because we expect mobility will continue to be the biggest driver of revenue growth and profitability and be a key factor in meeting our 2020 goals.

Second, a successful launch of HBO Max is critical to our plans in each of the next three years. Many of you are with us for the Analyst Day in October and have seen firsthand why we're so excited about HBO Max and the opportunities it gives us. We're right on track to launch it in May.

Third, is growing our broadband revenues by increasing our fiber penetration. Key to this will be bundling our fiber broadband offer with AT&T TV, which is delivered over our software based video architecture.

And finally, we're laser focused on improving both the effectiveness and the efficiency of our overall operations and as a result, driving additional costs out of the business.

Let me dive into each of these four drivers beginning with mobility on slide 11. Last year our wireless network was recognized as the nation's best and also fastest thanks in part to our FirstNet build. In fact, we did a few of our own spot test in December to see how our existing nationwide 5G evolution network compared to the 5G network one of our competitors rolled out last month.

In three out of the four test cities, our network had faster speeds and lower latency on average. The point is our strong spectrum position gives us a leg

up and allows us to execute a different 5G deployment strategy than our competitors. We have the low and mid-band spectrum to deploy 5G nationwide. We cover 50 million people today and expect to be nationwide in the second quarter.

We also have the millimeter wave spectrum we need to deploy 5G+ and its gigabit speeds and super low latency to more densely populated cities. We're in 35 cities today and we're adding more this year. There's an important point to be made here once we have 5G nationwide. As you know smartphone upgrades across the industry have been down for a while now. In fact, we're coming off a record low upgrade rate for any fourth quarter in our history.

But fast forward to the back half of this year when popular 5G smartphones and devices should be more available at scale, you can expect higher upgrade rates and equipment revenue growth.

The timing for this upgrade cycle couldn't be more perfect when you consider that we'll be offering HBO Max on our highest ARPU wireless plans with features tuned for premium media consumption and at a time when people are coming into our stores to upgrade.

It's a natural opportunity to further the distribution of HBO Max, while adding new mobility subscribers and improving our wireless ARPUs. HBO Max's content has something for everyone in the family and that makes it a natural fit for our nearly 25 million postpaid accounts that average more than three lines per account.

As a result, we expect our wireless service revenue growth rate to be higher in 2020. And after adding nearly 1 million phone net adds in 2019, both postpaid and prepaid, we expect 2020 will be an even better year for net adds.

FirstNet plays an important role here. We now serve more than 10,000 first responder agencies and more than 1 million connections with FirstNet. We expect those numbers will grow nicely as our FirstNet deployment reaches 80% in new devices and capabilities come to market in the coming months.

We also expect a higher adoption of our unlimited plans. We're at a little more than 50% penetration today, but we expect the 5G device upgrade cycle will bring into our stores lots of customers not on unlimited plans today.

Increasing the adoption of our best unlimited plans is obviously an ARPU growth opportunity for us. And when you add into the mix the customers on select unlimited plans will get HBO Max for free, it's a great opportunity to

also improve our overall churn which we've seen happen from giving HBO to current unlimited customers.

A reduction of one basis point of wireless churn across the base is worth about \$100 million to us annually. Sum it up; we're expecting growth of more than 2% in mobility service revenues this year.

Let's go to Slide 12 and the headlines for why we believe HBO Max will be a game-changer for our customers and for AT&T. I expect many of you were at the HBO Max Analyst Day in October and you heard me talk about the three pillars required for success in streaming; premier content; the technology platform; and marketing and distribution. Only AT&T has a space with a solid footing in all three.

My excitement and confidence in the HBO Max opportunity have only grown since then. The team has made tremendous progress in every area and we're on track to launch in May with a unique offering. Quite simply, we believe HBO Max will be the highest quality premium SVOD in the market with a great experience, better curation, and higher percentage of culturally relevant offerings than competing products.

We're excited to launch HBO Max coming off the tail end of one of our strongest awards seasons ever with new and exciting breakthrough offerings leading the way. We captured an industry-leading 34 Emmys and six Golden Globe awards. Joker had more Academy Award nominations than any other film, highlighting our deep and diverse theatrical content.

The awards are only the latest indicator that we continue to create high-quality culturally relevant content that appeals to a broad consumer base. And our additional investment in great content is only going to expand the appeal of the service. With HBO Max, we'll offer consumers more than twice the amount of programming for the same price as HBO today.

We're making great progress on the HBO product platform as well. Our controlled nonpublic beta is getting solid reviews and we're gaining invaluable feedback on important but subtle issues like user navigation and screen layout. This work is no less important than award-winning content.

Finally, we continue to fine-tune our go-to-market plans consistent with the unique position with which we enter the market, leveraging our extensive AT&T distribution and embedded base of more than 30 million domestic HBO subscribers. We're in active discussions across our potential distribution partners both digital platforms and MVPDs. We're making progress and we expect we'll have deals to announce prior to launch.

Our focus continues to be on providing a compelling value proposition for our HBO distribution partners and our mutual customers. Our more than 10 million HBO subscribers on AT&T distribution platforms will be offered immediate access to HBO Max at launch, so we'll get off to a fast start.

To drive incremental growth, we have unique advantages when combining media and distribution including our 170 million direct customer relationships across mobile, pay TV and broadband. Plus, we have 5500 retail stores who will be focused on driving incremental HBO Max adoption by bundling it with premium-tiered wireless, broadband or pay TV offers.

And we'll use AT&T customer insights for WarnerMedia advertising analytics and curation. We have very high expectations for HBO Max. And at the same time we're thrilled about the possibilities of increasing the adoption of higher ARPU services and strengthening the long-term value proposition of our highest quality and highest ARPU customers. We fully expect HBO Max will have a positive and immediate impact on the stickiness of our wireless and pay TV and broadband offerings.

Now let's look at Entertainment Group. Those details are on Slide 13. Our EG team delivered our target of stable EBITDA last year. In 2020 you're going to see us apply the same high-value customer-centric focus, while increasing our fiber customer base and launching AT&T TV. We'll see higher amortization cost in the video business in the first quarter which creates some tough year-over-year comparisons for EG EBITDA but on a cash from operations basis we expect EG to be stable in 2020 versus last year.

We believe the greatest opportunity within EG is to significantly grow our AT&T Fiber customer base and broadband revenues. We have 4 million fiber customers today and our recent fiber expansion gives us 14 million locations to sell into. Based on our fiber sales experience we expect to exit 2022 with about 3 million more fiber customers than we have today or a total of about 7 million. This will be a significant lift in market share compared to our traditional performance in our legacy hybrid fiber copper-based footprint.

It represents an organic market share growth opportunity on an existing product that I've never experienced in my career. Where we offer competitive broadband speeds you can expect that we'll lean into video acquisition given the better economics of our improved product portfolio including AT&T TV and HBO Max all software-based products with low acquisition costs.

Within our broadband footprint expected as we exit the year our premium video subscriber declines will be more in line with overall video industry

trends. Looking at our total premium video customer base, we expect year-over-year improvements in the subscriber losses.

Now let's turn to Slide 14 to talk about our efficiency and cost initiatives. New work to improve the overall efficiency and effectiveness of our operations has progressed over the past few months. We previously shared with you that we're targeting an additional 4% reduction in labor-related costs including benefits and contract employees in 2020 alone.

That work will ramp quickly and we plan for it to deliver \$1.5 billion in additional cost savings. In fact we've already identified and implemented about half of those savings. Another significant opportunity for us is product information technology rationalization. We feel comfortable that we can generate another \$2 billion of annual run rate efficiencies exiting 2022. This will come from thinning our product portfolio, simplifying our market offers, rationalizing call centers, modernizing our information technology and enhancing the level of customer self support.

In addition, streamlining will have the added benefit of enhancing our market agility and ultimately lead to improved market effectiveness. Our assessment work continues and I expect in the next 90 days we'll have additional efficiency initiatives underway for some of our network, corporate, sales and procurement functions.

I'll turn it back to John now for his look at capital allocation 2020 financial guidance.

John Stephens

Thanks, John. Strengthen our balance sheet was our top priority last year and our teams did an excellent job of reducing debt and monetizing our asset portfolio. This allowed us to begin retiring shares at the end of last year while still meeting our net debt ratio goals.

In 2020, you can expect that momentum to continue. It all starts with strong free cash flows. We had record free cash flow last year and expect to be in a similar range this year. We achieved this even with some voluntary funding for retiree medical costs and higher tax payments in the fourth quarter.

We also overachieved on asset monetizations. We expect to do another \$5 billion to \$10 billion net monetizations this year with significant efforts already underway. At the same time, we continue to evolve our capital structure. We added more preferred to our capital stack last year when we monetized more than \$6 billion of our long-term tower purchase options. And we also issued \$1.2 billion of traditional preferred stock.

The publicly traded preferred stock is new to us but there is a market for it and it provides investors another alternative to invest with AT&T. In fact, these shares are currently trading at a premium to par. Investors are looking for secured dependable returns, which is exactly what this offers. And dividend rates at less than our common stock dividend yield make it attractive for us.

The tower preferreds also allow us to use very long-term assets to generate cash in a tax-efficient manner. We also continue to be focused on our three-year debt reduction targets. Depending on the timing of share retirements and asset monetizations, you will see our net debt to adjusted EBITDA ratios fluctuate throughout the year but we expect to continue reducing debt for the full year and intend to target leverage in the two to 2.25 range by the end of 2022.

Our share retirement has begun in earnest. We told you we wanted to buy shares as early in the year as possible and that is what you're seeing. Thanks to our \$4 billion ASR, we've already bought back about 85 million shares in January and expect to see another 20 million in the remainder of the first quarter.

You can expect us to continue to buy back shares during the remainder of the year and meet or exceed our 250 million share retirement target for 2020. That's on top of the 56 million shares we bought back in 2019. We have a lot of levers we can pull to optimize our capital structure. We're focused on managing debt and have a wealth of opportunities with our balance sheet as we showed last year. You can expect us to continue to manage it in a prudent way including issuing additional preferred shares.

Now let me revisit our 2020 guidance on Slide 17. Our guidance remains consistent with what we told you in October. This year more so than most, our results will be more weighted to the second half of the year. For example, in the first part of the year, we expect pressure from heavy HBO Max investment, which you saw begin in the fourth quarter.

And in EG, higher content and noncash amortization costs as well as continued pressure on video subs. But in the second half of the year you will see our momentum build. For example, share retirements have been aggressive and will continue and the EPS benefits will flow increasingly throughout the year.

HBO Max will have launched leading to strong subscriber growth. The run rate benefits of our cost reduction plans will be clearly visible. And 5G combined with HBO Max will drive more upgrades and stronger wireless

revenue growth later in the year. Again, all of this has been factored into our full year guidance.

With that in mind, here's what we've committed to: 1% to 2% revenue growth; adjusted EPS of \$3.60 to \$3.70 a share; stable adjusted EBITDA margins; free cash flow in the \$28 billion range, with our dividend payout ratio in the low 50s; gross capital investment in the \$20 billion range and this doesn't include our investments in content; continued debt reduction with share retirement of 250 million or more common shares in 2020; and our net asset monetizations between \$5 billion and \$10 billion.

Mike, that concludes our presentation. We're now ready for Q&A.

Michael Viola

Operator, we'll take the first question.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] Your first question comes from the line of John Hodulik. Please, go ahead.

John Hodulik

Great. Thank you. Maybe a couple of questions for John Stankey. Yes. Thanks for the commentary on the entertainment sub trends, but maybe a little bit more clarity. I mean, first of all, you saw a slowdown in fiber adds in the quarter. What was driving that? And, I guess, in conjunction with the guidance for sort of more improvement in the back end of the year, do you expect that trend to reverse?

Or when -- how do you expect those adds to sort of play out over the course of the year? And what drives the acceleration? And then, in terms of the HBO Max guidance, the \$500 million in incremental expense we saw in 2019, does that impact your guidance for the \$2 billion in 2020? Thanks.

John Stankey

Hi, John. Happy New Year. So, first of all, fourth quarter of 2019, fourth quarter is seasonally a slower quarter. December is a pretty slow month in general for home-based services, given the dynamics of the holiday and the like, so that's part of the contribution to the issue of the slowdown.

The second is, our gross add performance on video wasn't strong. You see the subscriber trends. As we've shared with you, as we move through this

year and we start shifting to AT&T TV, our gross add performance starts to get much stronger. And naturally, when you're able to put AT&T TV, a software-based product with fiber, it's a much more natural combination than a satellite dish and fiber. And so, as we start to roll out AT&T TV now in markets and we move in, we're going to see much stronger performance on the fiber side.

I'll tell you, as I look at where we are right now in current customer trends, I feel pretty good that that's, in fact, the case and we're going to be where we need to be on that. Frankly, it's not a hard sell. It's a great product. It's a product that customers like. I think, we could do very well with it and I don't expect that we're going to see that continue through. So, that's what I would tell you. You're going to see recovery in 2020.

On the Max side, we gave you a range on what to expect in 2020 in terms of dilution, that we're not changing any of that range. The range is a range for a reason. There's a lot of moving parts on Max introduction. It's a combination of both, going to market with subscribers and it's a product that's going to continue to grow over the coming years.

And we're going to be looking in the market for opportunities for other content acquisition and the like. And it's entirely possible, we may be opportunistic, or look at something and we want the management team to have that flexibility to be able to balance those things out. We have subscriber growth coming and things are working well with our strategies. We make it a little heavier on trying to build up subscribers and what we expected.

I think, that's the nature of building a new and subscription-oriented business. And so, that range is important that we have the flexibility for the management team to do what they want to do. We feel very strongly we're going to get back that investment as we build this new distribution platform over the coming years, that's why we're doing this. We like the dynamic of ultimately having some control of those customers and being in a position where we can manage that life cycle going forward. And we think it's a good smart long-term investment.

John Hodulik

Okay. Thanks, John.

Operator

Your next question comes from the line of Philip Cusick. Please go ahead.

Philip Cusick

Hi, guys. Thanks. John, can you update us on the WarnerMedia strategy from here away from Max? We see video industry bundled units declining pretty quickly even away from you as you decelerate. How does that change your thoughts on Turner over time and the strategic value there?

And then can you also give us an update on the low-value video subs that are remaining in the base and how those should come out over the next few quarters? Thanks very much.

John Stankey

Sure. Happy to do that Phil. So, if you step back and think about the position we sit in the -- what I would call the traditional pay TV universe, I mean everybody knows it's in transition. And it's a mature product that's kind of working its way through the back end of a life cycle. But I like where we stand in that and that our total percentage of cost of goods sold in that space relative to the size of the bundle that the customer buys is not huge.

Our network portfolio is a fairly concentrated network portfolio. If you think about it the bulk of our profitability comes from three primary networks, its TNT, TBS, and CNN. And I think if you look at trends, we all know that general entertainment content and the bundle is not performing as well and the nice part about our two general entertainment networks TNT and TBS, these are really hybrids. They're a combination of general entertainment and sports. And so they historically perform at the upper end of desirability from a ratings perspective and attractiveness from an advertisers' perspective because of that mix of content that we have. So, one having more contained portfolio; and two, having that mix of content I think is important to basically ride through this transition and have some resiliency.

And my view of what's been happening in most carriage agreement negotiations, as we go back out in the market and renew things is our distributors see that and understand that those are important networks to carry forward. And we're continuing to see that people place value on those things even in a more skinny down or a smaller pay TV universe moving forward and feel pretty good about that.

Now, let's be clear, the reason we're doing Max is we also know that new distribution platforms need to be out there that are the growth platforms and that match general entertainment content how consumers want to see them. And that pivot between what we're doing with linear networks and what we're doing with Max is a key part of the WarnerMedia strategy. It's an important dance and choreography that we have to do to get that right. And we feel we're positioned very well and make that happen. We spent a lot of time in the Investor Day explaining why we think it's a natural place to go.

To keep the networks relevant what you should expect us to do, we will continue to invest that -- in them. We'll continue to make sure that they're viable for our distributors, but you'll see the content shift start to occur a little bit. What we see with subscribers is that obviously they like news and sports. They also like content that's socially relevant. And so probably a mix of starting to see a little bit more unscripted content come in, things that cause people go into the office and talk about it around the water cooler. And that will probably start to supplant hours. It might have been more general entertainment-oriented content that you are going to see showing up on SVOD platforms like HBO Max moving forward.

And we think that mix in conjunction with what we're doing with Max will allow us to ensure that the content we're producing in our great studios across our different brands will have a place to market that we can monetize with end user either through distributors in the traditional fashion or through direct-to-consumer constructs where maybe we have a direct relationship with the customer.

On the subscriber pay TV low-value construct, look we're mostly through that. I would tell you we've got a little bit more work to do on some promotional roll-offs in the first quarter that is going to continue to show up. And when we shared -- as I shared earlier, what's going to happen on subscriber trends that I think will be more at the rate of decline by the time we exit this year, you should expect you're going to see continuing improvement in our subscriber trends each quarter as we move through.

But I will tell you, you just can't flip a switch and get there overnight. And that's why I'm kind of suggesting you should think that we're on a glide path to get back to that ratable decline with subscriber base decline in the aggregate pay TV industry by the time we exit the year.

We're going to see probably our heaviest losses in first quarter. When I look at what's happening from an operational performance perspective and what the team is doing on gross add improvements, what we're seeing in churn improvements, the rollout of AT&T TV that really hits its stride in the second quarter in terms of its availability across the customer base, we'll start to see those subscriber trends incrementally improve as those capabilities start to roll into the base. And we'll get to what I just indicated by the time we exit the year.

Philip Cusick

That's helpful. Thanks, John.

John Stankey

Thanks.

Randall Stephenson

Take the next question Greg.

Operator

Your next question comes from the line of Simon Flannery. Please go ahead.

Simon Flannery

Great, good morning. Thank you. Randall, we put out a lot of targets here for 2020 and beyond. Perhaps you could just share about how the executive incentives are being set up for the year, what the KPIs and metrics are. I know last year deleveraging was I think 25% of the short -- or 20% of the short-term comp. So any color you could give around what the two or three key focuses are for the year?

And then one for John Stankey, you talked about the investment in the network, the capacity there. I think in the past you've talked about the opportunities in the wholesale market. Perhaps you could just give us an update on how things are going there and the opportunity perhaps to sign up some cable companies. Thanks.

Randall Stephenson

Hi, Simon this is Randall. Yeah, as you articulated and for those who aren't familiar, coming into 2019 I told all of you that our number one priority for 2019 was to reduce our debt and get our leverage ratios down to 2.5 times debt-to-EBITDA. And it was going to require strong cash flow generation, selling some non-core assets. All that was instrumental in getting there. And to really drive at home and get the focus for the management team as you said, we set that debt-to-EBITDA target as a significant amount of executive compensation and mission accomplished.

I think the team executed at an amazing level in terms of identifying asset opportunities to dispose, getting those things driven through the process, negotiated actually getting good prices for all of those assets and then driving just strong cash flows and some impressive working capital opportunities we're taking advantage of and these working capital initiatives that are put in place are not one and done. What we're most excited about are these are working capital initiatives that are repeatable. And so I feel really good about our ability to generate in 2020 even with the HBO Max investments another \$28 billion of free cash flow.

Coming into this year, the debt objective of 2.5 times isn't what we're working towards. What we're working towards is making sure we're continuing to generate the cash flow to execute the broader capital allocation strategy, meaning more specifically retiring the shares we issued for Time Warner. And as both John Stephens and I articulated in our opening comments that is a focus, and our objective is to retire at least 250 million additional shares this year. We'll get about 100 million of those knocked out in the first quarter. And there's at least 150 million more to be coming in the back part of the year that will generate nice EPS accretion as we move throughout the course of the year.

And so all that said, the management team is going to be focused on hitting these earnings objectives that we've laid out for you and the cash flow targets. And that's what compensation will be really focused on. And I think it's going to be effective in generating the cash we need to execute the share buyback programs and the overall capital allocation strategy.

John Stankey

Simon thanks for asking the question, because I think it highlights a really important aspect of how we're going to grow wireless revenues next year, because we already have that strength as you indicated the network performance and that perception.

As we do research out the market is now starting to grow amongst the customer base. I think we have some plans to even fine-tune our brand positioning messages as we move into this year a little bit more. And we know that as we move that perception, which is happening right now, we see momentum in subscriber growth.

And so we've got just pure subscriber economics that are going to help us there, make some shifts in distribution. We've got the tailwinds of FirstNet behind us, which are starting to help us dramatically. And I think the coverage improvements that occur as we get into the second phase of FirstNet will allow us to move through that. And then we talked about just a few minutes ago what we're doing on the upgrade cycles and the Max launch. There's a lot of good things moving our direction what I would call the core organic part of the wireless business to grow revenues.

And frankly over the last several years, our wholesale business had been a bit of a headwind in our wireless business, because we didn't have the flash capacity that we've now been able to turn up with these key investments over the last 1.5 years.

We're now in a much different position than we've historically been and where we've had to be very guarded about our wholesale position largely because we needed capacity to support our retail base.

And we're now, I think in a position in the industry when I look at what has to happen with people either in a deal or no-deal situation in spectrum and their spectrum holdings that we are probably more flashed than others in the industry. And we can in fact play in a different way in the wholesale space.

We're not just focused on cable. I think we want to do as I've indicated previously the right deal, a deal that's constructive for the industry in general. Certainly if there was an opportunity to do something in that space, we might do it. But there's a lot of other wholesale options out there that we expect to lean into and I expect we can step up to in the most accretive fashion possible.

And what I would indicate to you that I think whether you believe a T-Mobile, Sprint deal occurs or doesn't occur either way they are going to need to be partners in the industry that need to round out networks and do some things differently. And we would also try to understand whether or not we have other partners in the industry or merging partners in the industry that we can help with on the wholesale side.

So, there are plenty of options for us to go and start pulling that wholesale lever and driving it up. And I think that will be an incremental difference for us than what we've seen over the last couple of years that we've been managing that number down.

John Stephens

Simon to add to what John said, this is the first year that we've had stable reseller revenues throughout the year. And in fact sequentially, we grew reseller revenues and in year-over-year and the fourth quarter. So what John is talking about, we are not only well positioned for, but it's starting in a small way right now but with the opportunity to make much bigger. It's already occurring and it's contributing to that service revenue growth that we've had both in the quarter and the year.

Simon Flannery

Thanks.

John Stankey

Thanks Simon. We'll take the next question.

Operator

Your next question comes from the line of David Barden.

David Barden

Hey guys. Thanks for taking the question. I guess two, first John Stankey your -- it sounds like you guys really have bought into this idea of 5G smartphone super cycle. And I feel like that is not a consensus view. I know that there's a lot of debate about it internally here between our tech guys and our chipset guys and our phone guys.

And so if you could kind of give us some perspective on where that conviction comes from that that we're going to get enough of a boost in demand for products that, I don't know that the consumers really understand it's a lot different than what they're already buying that would be super helpful?

And then John Stephens, could you walk us through the science behind this kind of new embrace of the preferred securities? Because it seems a little odd to be buying back stock, but then at the same time issuing preferred stock and debt has deductible interest and preferreds don't. And so I think that there's some confusion as to kind of what the net benefit to the equity holder is of kind of looking at preferreds and capital stack? Thank you.

John Stankey

Dave so I don't know that I would use the term super cycle. I don't look at the plan and say, we're expecting a super cycle. But we are expecting an increase or a step-up in what's occurring. And look I think that the foundation of that assumption is based on we've done a couple of different area interface changes. We did the UMTS air interface change. We did the LTE air interface change. And I think there were similar discussions going on at that point in time.

Well will somebody really need the increased LTE speed over UMTS? It works perfectly fine. And I would tell you we do see this step-up occur because naturally speaking people have a tendency to sit around and run speed test on their devices. And when somebody next to them is getting better performance, it raises awareness amongst the subscriber base.

And I expect that there's going to be a certain number of folks who look at that and just say because that device performs better because these new devices have access to a much broader swath of bands it's going to perform better. And we are going to see a degree of uptick simply because the

subscriber base is going to notice that there is a degree of performance etcetera as a result of that.

Secondly as I said we're going to be driving some of this ourselves. We're going to be out there with some pretty aggressive promotion on HBO Max and we're going to be tying these to our better plans. And when you look at what we're assuming in our business plan for the year, our increases in the number of customers moving into unlimited aren't crazy silly step function changes. They're more of the trend and taking advantage of the fact that we are going to put more advertising dollars into the market to support Max and support 5G.

And we'll get some nominal uptick in what those migrations into our higher-value unlimited plans are. So we want to stimulate some of that. We're coming off of historic lows of upgrades. And we think the market is set up to basically go through renewal cycle given, how we're promoting. It's coming at the end of the year in the holiday season. There's going to be better networks out there. We do expect there's going to be an uptick in the upgrade cycle. Super cycle maybe a little bit too strong a word than an uptick yes.

David Barden

Got it.

John Stephens

And just to add to what John said, we have had three years here of very low upgrade rates. Just to some extent people are going to need new phones. And so this is just also this aging of the phone base has been occurring over multiple years. Secondly, this is the first time we're going to have a 5G network up and running and available before the devices are out, the next-generation networks in there. And as John made very clear, the HBO Max and other products we have they would really meld well. The convergence of all three of those things is going to be really attractive for us.

With regard to the science of a preferred it's simply this. The market is open to it. Investors want it. They like this certainty. At today's rates, our preferred that's out there is actually trading below 5% yield about a 4.7%, 4.8%. I am seeing it today about a 4.8% yield. So that's lower cash cost than our common dividend, so that saves us money there. Secondly, as you know they don't share in the common profits of it. Third, it's a diversification for us. And so it gives us an opportunity to go into a different investor base. So just like we had done over the last 10 years have really diversified our debt base. This gives us an opportunity to diversify our shareholder base.

And we believe that that's good for everybody and also allows us to bring in the volume or the quantum of common shares that are out there.

Additionally, when you look at the preferred partnership interest that we've done and the preferred interest, we've done there, that has a very efficient – those dividend costs are much lower, because they're very tax efficient. So those costs get well below 4%. And once again, they allow us to give recognition to assets that people may not have realized. For example, our tower receivables and over \$6 billion worth of real option cash that we have a high likelihood of getting, I don't know that anybody was paying much attention to that. Now it gives us the opportunity to put that spotlight that we really already achieved that value. So – but the clear science of the preferred is; one, the dividend costs are lower than our common; second, they're stable and our common is going to continue to grow; third, it gets us to another market segment, another investor base which is helpful; and fourth, that allows us to reduce the reliance on the common share base that's out there. For that perspective, we feel very good about. I feel like it's a really – it's a good move for all of our shareholders.

Michael Viola

Thanks, Dave. Greg, we will take the next question.

Operator

Your next question comes from the line of Michael Rollins. Please go ahead.

Michael Rollins

Thanks and good morning. If you fast forward to the end of your financial plan in 2022 given the CapEx that you've articulated, can you frame what the network capabilities are going to look like for 5G mobile, fixed wireless broadband coverage, and fiber-to-the-home coverage? And then secondly, can you just unpack a little more of what you see driving the strength in industry wireless postpaid phone net add? And as you look at your own customer trend are you seeing any meaningful differences in customers and markets that have 5G evolution versus those that haven't received it yet? Thanks.

John Stankey

Sure. So, Mike, let me see, if I can hit a combination of things you laid out. So first of all, I think one of the significant shifts you'll see in 2022 by the time we get to that point and a lot of this is being driven by work on FirstNet is I think we'll be in a much better position on macro coverage and not only from a number of square miles, but I think you're going to see the

improvement in core interior performance given how we densify things to support our FirstNet subscribers and the agencies we have there. And as I said, this is really – where last year was a year of us getting coverage – macro coverage in place kind of getting the umbrella, the footprint turned up this year is where we do a lot of the – make the network better stuff. So we've been doing all the site acquisition, all the fill-in. And we start turning up sites and just going to make the network better. It's going to make the network better on the inside of a building that's going to make the network better in terms of the square miles that are covered.

And when you add that to the great spectrum position that you're already seeing and the wonderful reviews of speed and performance that we're getting back on test today, that only makes things stronger.

Secondly we are as you know in filling with millimeter wave and we've already turned up over 30 markets with millimeter wave. We're continuing to increase that footprint. And we're going to be very opportunistic of where we can do that. We're in a unique position especially in the places where we offer wireline businesses that we can densify on a fiber infrastructure in a way that's really economic and is advantageous to our cost structure as we move forward.

That millimeter wave fill-in is where you're going to get unique performance characteristics. It will be obviously, probably more pronounced in the urban areas of large cities. Our plan right now is we're not as optimistic as maybe some are on what I would call the fixed wireless replacement construct. We obviously believe there'll be some part of the subscriber base that might decide that they don't need a fixed broadband connection.

I think that's going to take a couple of years to start to emerge when you get the density a little bit more robust, I think as we see more mid-band spectrum coming in place to support the millimeter wave and make the performance a little bit more consistent.

So I wouldn't tell you any of our financial plans and our business plans. We're out there expecting wonderful revenue increases from a push in the fixed wireless space. On what we do in the fixed space, you should expect that we're going to continue to add to the wireless – excuse me, the fiber footprint.

Right now as we've shared with you our goal is to get a little better return out of what we've deployed because between consumer and business we have about 20 million locations, we can be aggressively working penetration in. And we think that we need to ensure we've got the right business

practices and marketing practices to get the return on that footprint that's there.

And as soon as I get indications that the team is actually executing on that well and we have the right formula on it, we'll probably release the ticket on some additional bill. You should expect just by natural growth of the population, you'll probably see somewhere between 350,000 to 0.5 million new fiber locations coming into the portfolio. Right now that is just kind of what I would call the natural growth rate that's going to happen.

If we step that up a little bit, it will be because we feel good about how we're executing on the embedded footprint we have in place. And we know exactly where the next incremental place as we go and build. And I think it's entirely possible that this operating team could build another 1 million to 2 million a year, if we felt like we had the operating momentum to do that.

On the postpaid trends, look there's – the difference between prepaid and postpaid is changing. It's getting – they're getting closer together. We've been in a situation where we frankly as we shared with you our prepaid base looks a lot more like a postpaid base in what may be the broader industry prepaid base looks like.

Once we get these folks on prepaid, once we get them on smartphones, we start seeing churn characteristics with multiline accounts that are very similar to what we have in postpaid. And so, I think as the economy has improved as the differences between the two products have gotten a little less as smartphones have worked their way into the prepaid base because of the cycle of maybe previous generation phones being available, we see customers now starting to opt into a postpaid construct.

Does that reverse itself, if we see some economic headwinds and maybe people become a little bit more careful about what they do? That's possible. But the net of it is when you look at whether a customer goes with our prepaid offer or a postpaid offer, we have a lot of similar characteristics between the two. It's – we can hit them in both places. But we feel very comfortable that we can catch the transition if there's more of a move to postpaid which is what I think is occurring, largely driven by economy and the way the networks are performing and the differences between the two products.

Michael Viola

Thanks Mike. Great. We'll take one more question.

Operator

Okay. That question comes from the line of Kannan Venkateshwar. Please go ahead.

Kannan Venkateshwar

Thank you. A couple if I could. Firstly, I mean, when you think about the decline rates of video at DIRECTV, although it will moderate over the course of 2020 based on your guidance. If at some point, DIRECTV becomes smaller than say Comcast and because of the video losses and those lines cross, is there any kind of an impact on your programming cost because of the most stable nation clauses and others that you get on account of your scale? And how does that impact margins if it does?

And secondly, when you think about the attach rates for broadband in video homes, could you give us a sense of what that is? And within the base of homes that you've lost as a result of the promotional loss last year, is it in line with the average? Or is it higher or lower? That will help us get a sense of where trends are. Thanks.

John Stankey

So, the short answer to your first question Kannan is, no. We -- first of all, as you're aware, we went through a fairly significant renegotiation cycle over the last 12 months, so those are all baked in the bag through the next three to five years depending on the nature of the particular content and I don't see any exposure in any of those agreements. I would suggest we're not going to continue to pay at the best part of the rate card given the size and the scale of our business as we move forward.

I think frankly, what's more likely to happen in pay TV moving forward is what I talked about earlier, where I think there'll be some pruning and trimming of offers in the market. As folks move forward to manage their cost of goods sold on programming costs, it will be dropping or shifting away from less traffic networks. I think that's going to be a bigger driver of cost structure than renegotiation or anything around that. But we're pretty well baked in that regard.

As you know, one of the things we're working through is, we have a step-up in our content cost as a result of that significant renegotiation work we did last year. We're going to have to work through that in 2020. And then in the subsequent years '21, '22, you'll see us on what I would call more industry traditional step-ups year-over-year in programming costs. But we're in the bag on those things and I think we're in pretty good shape.

On the broadband attach rates, the attach rates in footprint where we offer broadband are extremely high and they haven't changed. We would expect

to see a modest step-up as we move away from satellite combined with broadband and get into our software product distributed over broadband. Those sales rates, I think will help us on gross not necessarily a significant change in attach rates. When we are successful selling, we typically attach both.

The reality is, is we want more gross. We don't necessarily want to change the attach rate. We get more gross by the fact that for example in footprint, solid 10% of those subscribers have line of sight related issues on satellite. They won't have that on the software-driven product. That helps us on gross intake and that's one of those things that help us -- helps us as we move through this year change those subscriber trends.

Randall Stephenson

Okay. This is Randall. First of all, I just want to thank everybody for joining us again this morning for the call and your interest in AT&T. We're coming from off of 2019 where we told you exactly what we're going to do. And in terms of debt repayment, operational performance et cetera, capital allocation, we checked every box. We've now given you our playbook for 2020 through 2022. It's a playbook that we feel very confident that we can achieve. We're now gaining momentum in our wireless business, which we feel very good about that. We have a capital allocation plan that we have a high degree of confidence and we'll be able to execute over the next three years. And we have a media business that's performing at a very high level even in an industry that's in transition.

And with HBO Max coming and the investment we're making there, we're confident that it's just another growth vehicle for this business over the next three years. So, bottom line, we have a plan that we think stacks up very nicely. We're confident in our ability to execute. We love the management team and look forward to 2020. Again, thank you for joining us this morning.