

## **Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the 2016 AT&T First Quarter Earnings Call. At this time, all lines are in a listen-only mode. Later, there will be an opportunity for your questions and instructions will be given at that time. [Operator Instructions] As a reminder, this conference is being recorded.

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

## **Michael Viola**

Thank you, Kathy. Good afternoon, everyone, and welcome to our first quarter conference call. It's great to have everybody with us today. Joining me on the call today is John Stephens, AT&T's Chief Financial Officer. John will cover our results, and then we will follow with a Q&A session. Let me remind you, our earnings material is available on the Investor Relations page of the AT&T website. That's [ATT.com/investors.relations](http://ATT.com/investors.relations).

Of course, I need to call your attention to the Safe Harbor statement before we begin. The Safe Harbor says that some of the comments today may be forward-looking; and as such, subject to risks and uncertainties, and results may differ materially. Additional information is available on the Investor Relations page of AT&T's website. I also want to remind you that we are in a quiet period for the SEC spectrum auction, so we cannot address any questions about spectrum today.

Now, before I hand the call over to John, let me quickly call your attention to slide 4. Slide 4 provides a consolidated financial summary. We had a very good first quarter at AT&T. First quarter consolidated revenues grew to \$40.5 billion, largely due to the acquisition of DIRECTV, but we also saw growth in video and IP-based services on a comparable basis. This offset pressure from lower equipment sales as well as foreign exchange.

We continued our streak of double-digit adjusted EPS growth, and after adjustments – and, by the way, the adjustments included removing over \$700 million of benefit from spectrum swaps with other industry participants. And so with those adjustments, first quarter EPS was \$0.72, up 10.8%. This strong growth comes even with about \$0.03 of earnings pressure from our Mexico wireless operations.

Margins also continue to be a great story. We saw consolidated margin growth, with margin expansion in every domestic business segment. Operating cash flows were up more than \$1 billion year-over-year, with free

cash flow of \$3.2 billion, a 17% increase from a year ago. Capital investment is on plan, coming in at \$4.7 billion.

And so with that, I will now turn the call over to AT&T's Chief Financial Officer, John Stephens.

## **John Stephens**

Thanks, Mike, and hello, everyone, and thanks for being on the call. As Mike said, we turned in another solid financial performance. Revenues grew, margins expanded, and we had our fourth straight quarter of double-digit adjusted EPS growth. Growth in strategic business services, IP broadband, and video were big factors. And ad sales in our entertainment group is now more than \$1 billion in annualized revenues and growing.

What makes our revenue results even more impressive is we did this with lower equipment sales and with more than \$500 million of pressure in foreign exchange and with the ongoing pressure of exiting some of our marginal businesses.

We are on track to reach a run rate of \$1.5 billion in cost synergies from the DIRECTV deal. We are also taking cost out of the business and driving greater savings through efficiency initiatives such as Project Agile, and transforming our network with software. This gives us the financial flexibility to invest in growth initiatives such as our Mexico operations.

At the same time, we are also executing on our commitments to transition and transform our business. We've been consistent on this for years, transforming our smartphone base, transitioning from subsidies to equipment plans, moving our broadband-based IP and our legacy database to strategic services. We have done a lot of work, but we have a lot of more to do.

Our video customers are shifting to satellite. We are moving our 2G customers onto our new LTE networks and we are continuing to use bundling offers to take advantage of our integrated networks. All of this makes us feel really good about our direction and the strong start to the year. We've built a solid record of setting goals and achieving them. We are very confident that we will continue to do that and transform our business.

Let's now take a look at our business operations, starting with growth in our business solutions segment. Those details are on slide 6. Solid wireless revenue gains drove overall growth in business, and more than offset lower equipment sales and foreign exchange pressure. Total business solution revenues were up slightly, with business wireless revenues up 2.3%,

reflecting smartphone and tablet gains, as well as more customers on lower-churn business plans.

Margins also continued their growth trend. EBITDA was up more than \$300 million as cost reductions added to our revenue gains. Margins grew to 38.7%, up 180 basis points year-over-year, thanks to a focused performance by the entire team.

Looking at our customer segments in business, all retail customer segments showed growth and our wholesale business is on plan, even though revenues were pressured. Legacy data continues to migrate to our IP strategic business services.

Total wireline data grew slightly in the quarter, and is now about 60% of wireline business revenues. Driving that growth is strategic services. Revenue grew by nearly \$250 million over last year's first quarter. That is up 9.3%. And if you adjust it for foreign exchange, growth would have exceeded 10%.

Strategic business services are now more than \$11 billion in annualized revenues. We also are seeing continue demand for highly secure mobile business solutions. Security continues to be the top of the mind for our business customers. Every enterprise must rethink its place in today's connected world. We are managing highly secure networks, given our unique experience. And our ability to provide business solution sets us apart, and we intend to be very active in this space.

Now, let's move to our entertainment group results on slide 7. As a reminder, our entertainment group provides video, broadband, and phone services to residential customers. On a reported basis, entertainment group revenues showed strong growth due to our acquisition of DIRECTV. However, if you look at results adjusted to include prior-year DIRECTV on a comparative basis, revenue still grew by more than 3% as IP, video, and advertising revenue growth outpaced legacy service declines.

Our high-speed Internet service grew by more than \$250 million and now generates more than \$7 billion in annualized revenue. And we are seeing solid growth with our add sales, which are now more than \$1 billion annualized revenues and going strong. At the same time, we again saw exceptional margin expansion, which points directly to the profitability benefits of the merger. Our EBITDA margins nearly doubled year-over-year.

Taking a look at our metrics, satellite net adds continue to be strong as we added more than 300,000 in the quarter. Total entertainment group broadband net adds were positive in the quarter, driven by 186,000 IP broadband subscribers. We've done a great job transitioning our broadband

base to IP, and that transition is nearly complete. About 95% of the eligible broadband subs now have IP broadband. Half of these customers choose higher speeds, which helped drive the 16% revenue growth in IP broadband.

We also made several strategic moves in the quarter as a premier integrated communications company. We announced our new DIRECTV streaming services in the first quarter. We are actively working the content deals for these new services, and we are on target for launch in the second half of the year.

And Fullscreen's ad-free subscription service launched today. Fullscreen is majority owned by Otter Media, a partnership between AT&T and the Chernin Group. AT&T has signed on as the premier launch sponsor for the new service, and will collaborate with Fullscreen to market and promote the service with special offers for AT&T's more than 100 million video, mobile and broadband customers.

We are also seeing our broadband [audio dip] DTV go up. The attach rate of DTV sales with broadband in our wireline footprint has increased 50% since last summer. And in GigaPower areas, the attach rate improvement is even greater. Our new unlimited wireless with video offer started fast and continues at a solid pace. More than 3 million wireless subscribers signed up for this plan at the end of the first quarter with thousands more being added every day. These are some of our highest ARPU subscribers who are even more valuable to us now that they have combined these services.

Our entertainment group team is performing well on every level: merger integration, cross-selling, special bundle offers, advertising, and now streaming services. But the second half of the year is when our integration efforts really take hold. Single truck rolls, cross-selling, and new product rollouts are just beginning to take off. We are on track with all our targets, and we are very excited about what is to come.

Now, let's move to our U.S. mobility results on slide 8. Another reminder, AT&T's domestic mobility operations are now divided between the business solution and consumer wireless segments. For comparison purposes, the company is also providing supplemental information for its total U.S. wireless operations.

We continue to see margin expansion and stabilizing service revenues in the quarter. Service revenues were stable year-over-year, thanks in part to having completed most of the transition to the Mobile Share Value plans, as well as adding new customers; while overall wireless revenues were down slightly due to lower equipment sales. We have changed the game with our equipment installment plans. We started the transition more than two years

ago with Next, and are substantially through that transition. Our strategy is working and you can see it in our results.

Our laser focus on cost efficiencies and fewer upgrades drove our best ever first quarter wireless EBITDA margins. Wireless EBITDA increased more than \$600 million when compared to the year-ago first quarter. And wireless service EBITDA margin came in at 49.5%, its best quarter ever.

Phone-only ARPU plus Next billing continued its strong growth. This ARPU was up more than 5% year-over-year, and also up sequentially. Nearly half of our smartphone base is now on AT&T Next. More than 70% of postpaid smartphone subscribers are on a no-device subsidy plan. During the quarter, we discontinued the availability of subsidized phones for most subscribers. This will drive continued growth in the no-subsidy model. In fact, 90% of postpaid smartphone sales and upgrades were all on AT&T Next or BYOD. Our branded percentage is even higher.

Now, let's look at wireless net adds. During the first quarter, AT&T posted a net increase of 2.3 million total net adds, our best first quarter ever. That includes 1.8 million domestic wireless subs. Net adds were driven by connected devices, branded phones, and tablets.

Branded domestic net adds, both postpaid and prepaid, were up more than 600,000, thanks to strength in prepaid. That included 137,000 branded phone net adds. And when you include Mexico, we had nearly 1.2 million branded net adds in our wireless operations, and more than 700,000 branded phone net adds.

Cricket continues to be a great option for our value-focused customers. We had 500,000 prepaid net adds in the quarter, and nearly 1 million prepaid net adds when you include Mexico. Our ARPU for the new prepaid Cricket subs continues to run about \$41. That compares to feature phones ARPU of about \$35. Feature phones make up the bulk of our postpaid phone losses. And the Cricket momentum continues to grow.

We expanded our cricket to distribution to Best Buy and Aaron's locations. Crickets will be available in more than 12,000 outlets across the country. We also just introduced a new Cricket unlimited plan, including talk, text, and data for \$65 a month with auto pay, and no hidden fees. We had 1.6 million connected device net adds, matching our best-ever net add quarter. We now have nearly 28 million of these devices on our network, and we are laying the foundation for future growth.

In the first quarter, we also continue to grow our high-value smartphone base. We added 1.1 million branded smartphones during the quarter. More than 95% of our postpaid phone sales in the quarter were smartphones, and

nearly 90% of our postpaid phone base has smartphones. Total churn was essentially stable year-over-year.

On a related note, we are moving forward with our previously announced shutdown of our legacy 2G network. We plan on decommissioning it by the end of the year. We have taken steps to migrate our 2G customer base, and expect most to take this transition. We expect to continue to see manageable pressure in the last half of the year from subscribers, mostly connected devices, choosing not to make this migration. While this might have a slight impact on revenues, we also see the cost benefits from shutting down the network; and the spectrum will be redeployed to help meet the growing data demand of our customer base.

Now, let's look at our international operations. That information is on slide 10. We continue the hard work and heavy lifting to make our Mexico wireless operations world-class. That includes deploying of 4G LTE network, integrating operations and support services, and rebranding to the AT&T name. The team is doing a great job with all of this. Even more impressive, they are adding customers at the same time. We added more than 500,000 wireless subscribers in the first quarter, and nearly 1.1 million in just the last six months. That brings our total subscriber count to 9.2 million.

Rebranding is also gaining speed. We've launched nationwide advertising where branding in Mexico City is nearly complete. Our LTE deployment now reaches 51 million people. In just a year, we're more than halfway to reaching our commitment to deploy LTE to 100 million POPs by the end of 2018. And we are also on target to reach 75 million POPs by the end of this year. First quarter revenue reflects seasonally lower equipment sales, as well as the impact of foreign exchange, as we successfully continue to execute our strategy.

In Latin America, our video operations continue to show solid revenue growth on a local currency basis, but foreign exchange rates significantly impacted our published results. Revenues are being hampered by a challenging economy. Subscriber pressures in Brazil impacted net adds, but foreign exchange also impacted lower company expenses. We did see sequential profitability trends in the quarter, and continue to expect self-sustaining cash flow for the year.

Now let's move to consolidated margins on slide 11. Consolidated margins reflect the overall strength of our business. EBITDA margins were slightly up, and adjusted consolidated operating income margin came in at 19.9% in the quarter. That was a 110 basis point improvement over the year-ago first quarter. Strong margin expansion in our domestic segments more than

offset nearly 90 basis points of margin pressure from our growth initiatives in Mexico.

Our drive to have the industry-best cost structure also is continuing on track. Efficiency initiatives and our software transformation are driving productivity gains and expense savings. On a comparable basis, our expenses were down more than \$300 million year-over-year, driven by excess costs efficiencies, automation efforts in service delivery, IT rationalization, and software savings. We also continue to see lower call volumes and improvements in cycle times for our efforts to improve the sales experience.

During the quarter, we also eliminated subsidized phones for most of our postpaid customers. This should sustain further margin improvement, even though most of our smartphone base is already off the subsidy model. Our margin momentum continues to be strong. We are confident we can continue to expand domestic margins and cut costs to offset pressure while in the investment cycle in Mexico. And we expect Mexico to improve its profitability late in the year. Cash flows were another strong story.

Let's take a look at the results on Slide 12. Along with solid earnings, the margins - we also continued to deliver strong cash flow growth. In the first quarter, cash from operations was nearly \$8 billion, up 17% year-over-year; and free cash flow was \$3.2 billion, also a 17% increase from the year-ago first quarter. The strong free cash flow growth comes even with more than \$1 billion of pressure from timing of fourth-quarter payables. With these first-quarter results, we are on track to meet guidance, and on plan to grow free cash flow for the year.

We continue to find ample demand and great rates in the securitization market to help us manage our Next receivables. We have received about \$1.5 billion in the first quarter, or about the same amount as last year's first quarter. Capital investments totaled \$4.7 billion for the quarter. Wireless CapEx is down slightly from the fourth quarter when we accelerated purchases of equipment to capture significant savings.

On average, wireless CapEx was about \$2.2 billion for the last two quarters. But not captured in those costs are investments in shared infrastructure. For example, running fiber to a cell site, but also using that fiber connection for our business wireline services. Shared infrastructure is about half of our non-wireless spending, and is one of the benefits from our integrated network carrier strategy. With our industry-best cell density and balanced spectrum portfolio, we're adding wireless capacity far more effectively and efficiently than anyone in the industry.

Our virtualization and software-defined networks are already delivering material CapEx savings. We will be adding 2.5 times more capacity at 75% of the capital costs compared to just a few years ago. In our other uses of cash, dividends totaled \$2.9 billion. Our net debt to adjusted EBITDA ratio declined to 2.27 times. And during the quarter, we successfully exchanged \$16 billion of DIRECTV debt, and issued \$6 billion of debt at very reasonable rates.

We ended the quarter with \$10 billion in cash and short-term investments, giving us the flexibility and financial strength to manage the overall needs of our business. Before we get to your questions, let me close with a quick recap of the quarter on Slide 13. The first quarter demonstrated our ability to deliver strong, consistent results as we execute the strategy we have laid out for you. Our approach has been methodical. Our results have been consistent.

We again grew revenues, expanded margins, and delivered double-digit adjusted EPS growth. Our DIRECTV integration continues to go smoothly. And we're on track to deliver a run rate of \$1.5 billion or more in cost synergies by the end of this year. We are also providing the first glimpse of what it means to be the premier integrated communications carrier in the world with our integrated offers and streaming plans.

Our business solutions segment continues to outperform the market with strategic service revenue gains and margin expansion. Wireless again had record margins, growing phone-only plus Next ARPU, and had strong growth with its Cricket prepaid perform. In Mexico, wireless is fast becoming an emerging growth story as we quickly build that business and expand our North American 4G LTE network.

We are convinced our strategy is working, and our momentum is strong. We are proud of what we have accomplished this quarter, and even more excited about what lies ahead.

With that, let's get to your questions.

## **Question-and-Answer Session**

### **Operator**

[Operator Instructions] And our first question will come from Mike McCormack with Jefferies. Go ahead please.

### **Mike McCormack**



Hi Guys, thanks. John, maybe just a comment on handset phone additions and postpaid, what strategies do you guys have in place to kind of turnaround or stem the losses there? I presume as the feature phone base continues to decline, that will become less of a headwind. And then just thinking about ARPU, I think the trajectory on phone on the ARPU without Next payments continues to get better. Is there a point at which you can see that starting to turn positive later this year?

### **John Stephens**

Yes, thanks for the questions Mike. Couple things; one, our strategies with regard to the overall business, but including our phone market is really on this integrated carrier strategy. So as we roll out these products that we can combine or video and our mobility and our broadband; and as we see these values net to the customers, we are optimistic we are going to be able to continue to improve our business. One other point I will make to you, though, too, is with these kinds of margins and these kinds of expansions in margins, it gives us the flexibility and, quite frankly, it grows the universe of customers that are long-term value-creating customers for us with these new margin standards that the team has set. So, we are real optimistic about being competitive.

With that being said, we are still viewing the Cricket and the prepaid platform as a very viable, profitable long-term strategy. We believe it gives us an entree into a market that is significant, and, as you can see, generating great results. We are seeing continued improvement in service revenues. We saw it, as you can see, in the first quarter, and in ARPU. So we are very positive about that. We believe there is real opportunity to continue that. But we will continue to worry about performing first, and predicting it afterwards. But we are optimistic; we like what we see. We like what happened when we combined the video and wireless offerings and the number of customers, for example, that not only added their phones, but added their tablets to the program. That was very encouraging, so we are really optimistic. Thanks for your question Mike.

### **Mike McCormack**

Do you think that is having a negative impact on ARPU, if you think about the tablets coming on, as well is the bundled offers? Or is that not a significant impact?

### **John Stephens**

The tablets come on at \$40 for the video offering, so they come in at a real strong rate. Depending upon whether they are a new and they are an addition, or whether they are a conversion of an existing tablet, you could

have different impacts on ARPU. But we are certainly very pleased with those coming on.

**Mike McCormack**

Great. Thanks, John.

**John Stephens**

Thank you.

**Operator**

Thank you. Our next question is from John Hodulik with UBS. Please go ahead.

**John Hodulik**

John, could you just maybe frame the service revenue impact you talked about with the second-half shutdown of the 2G network? I think you said you have gotten back to flattish. Is that going to change the dynamic in the second half, first of all? And then second, upgrade rate was even lower than we thought, at 5%. Obviously that also helped the EBITDA margins. How should we look at that over the next few quarters, both, say, the second and third quarter? Obviously, fourth quarter is a little bit of a wild card. But do you expect the same kind of margins in those quarters that we - the strength that we have seen this quarter? Thanks.

**John Stephens**

John, with regard to 2G, we have been on this path to convert our 2G customers for a number of years. If you recall, we first announced, I think a year and a half ago - or more than a year and a half ago - our plans for 2G. So we have migrated much of that base already, a significant amount. In fact, in the last 12 months, we have migrated something like 6 million customers off that base. And that has been flowing through the numbers that you have seen.

So, we are working through that on a regular basis already. So that impact is included in the service numbers that we - service revenue numbers that we've reported and that we talk about going forward. So it is already in that; and because of that, we're going to be careful. But it is already in that optimism that we have. With regard to the upgrade rate, I could see it continuing to be very moderate until a new device, until a significant or iconic device comes out. Once that happens, it's a little bit unpredictable. But I could see this, a lower rate continuing throughout most of the year.

**John Hodulik**

Got you. Okay, thanks.

**John Stephens**

Thank you, John.

**Operator**

Thank you. We will go next to Phil Cusick with JPMorgan. Please go ahead.

**Phil Cusick**

Hi guys, thanks. Similar theme, the overall video decline, a little better than we had expected; U-verse a little bigger; DTV a little better, so, two things: one, do you still expect that you can get to positive for the full year on the video numbers? And just confirm that that does not include the over-the-top product. And second, I have been under the impression that you are trying to stem some of the U-verse declines through some efforts. Is that still happening? Or are you going to sort of watch this tail off at this pace? Thanks.

**John Stephens**

Thanks for your question Phil. First of all, folks, we want to keep all our quality customers and so we will do prudent, rational steps to keep all of our customers, and keep them as part of our AT&T family. We are interested in doing that in any event. With regard to the video perspective, let me give you this thought. In the second half of the year, we will have had the integration efforts really completed and fully ramped. So, single truck roll, which for example, we didn't really start training nine of our states in the Southeast region until this year. They have now been all trained. But we will see that start to - we are seeing it have improvements now.

But as that becomes a normal part of the business over the next few months, and we get repetition with regard to the success base on that, and we continue to have all our sales channels fully up to speed and selling those territories as we add those single truck roll capabilities, we see real optimism on the second half of the year. Secondly, just from a traditional basis, I think the NFL package has a real positive effect on net adds, and it occurs generally in the second half of the year. And we think the ability to add further integrated products and expand our wireless bundling further will give us that opportunity to, for the full year, grow video customers.

**Phil Cusick**

I'm sorry, just not to push, but you had guided to full-year video growth. Is that still the guidance?

**John Stephens**

Yes. That's what I said. We are still getting there to total video growth. And we think those - the reasons I laid out; the fact the NFL contract comes really has impact on sales in the second half. The fact that quarter-over-quarter, every quarter since we merged, we've increased satellite sales. The fact that the full single truck roll integrated sales, integrated customer service, will be most effective in the second half of the year will give us that ability to add video for the year.

**Phil Cusick**

And it sounds like that does include the stand-alone over-the-top product, or it does not?

**John Stephens**

No, we don't have - we have not made any predictions on the stand-alone over-the-top video product yet. And so we are expecting to reach positive with not including those numbers.

**Phil Cusick**

Perfect. Thanks, John.

**John Stephens**

Sure.

**Operator**

Thank you. We have a question from David Barden with Bank of America. Go ahead please.

**David Barden**

Hi guys, thanks for taking the questions. First question, John, would be just in terms of getting to the \$1.5 billion synergy savings run rate by the end of the year. Could you kind of size what was this quarter, and what is on the come for the rest of the year? And then second, just on the unlimited, I saw in the disclosures that there's about 3 million unlimited customers. Obviously some of those are going to be related to the video bundle that you are doing. Could you talk a little bit more about the learnings, about what people are doing with mobile video, with an unlimited wireless capability? And what

is the economic model that you see supporting giving away unlimited data for this purpose? Thank you.

## **John Stephens**

So, the first thing with regard to the \$1.5 billion, we are making real progress on our content cost savings. We are getting those from new content - contract negotiations; as well, quite frankly, as the fact that our base is shifted more to DTV, and we get that from the existing contracts. Two, we got a lot of it from our headquarters advertising the traditional things you find with headquarter companies merging together - those savings in professional fees and contractors in consulting fees settings - we are getting that. And then we are seeing some savings, and we would expect to see more as we go through not only on the expense side, but on the cash flow side from aligning vendor contracts, best price of both companies' contracts, and best payment terms. So those are what's underway.

We've been at this almost 9 months now, or a little over nine months, and it's going relatively well. We're encouraged, not only that we are going to meet the \$1.5 billion run rate, but that we have the opportunity to exceed it. So that piece of it, David. I think the first thing on the 3 million unlimited, those are the customers that are buying video from us. Many of those customer, most of those customers, were already buying a video product from us. So you can imagine when they buy the video, when they buy the wireless, and they often buy the broadband, these are some very high ARPU customers, and customers that are very valuable long-term to us.

And so, giving them this opportunity to use our services any time, any place, where they live and work is very positive for them and creates not only satisfaction for them, but also high value for us. It also has added some video customers. We have been able to use this as an opportunity to add video customers for the wireless customers who want to get this opportunity. Secondly, we are still in the learning stage of it. But we are still finding that 80% of our video traffic, or some number like that, is on Wi-Fi or it gets offloaded very quickly. So, while the impact is convenience for the customers, so far, it looks like it is going to be a manageable exercise for us. We are continuing to evaluate it, and we're going to continue to learn. But the common place where people use this video still allows us to have Wi-Fi supplement for it, and that is providing us some measure of opportunity for success. But the real issue is when the customers are paying us for all those services, it makes real sense. We can really get comfortable with offering the unlimited. So far, it is working well.

## **David Barden**

Alright, thanks John.

**John Stephens**

Thanks.

**Operator**

Thank you. Our next question comes from Amir Rozwadowski with Barclays Capital. Go ahead please.

**Amir Rozwadowski**

Thank you very much and good afternoon folks.

**John Stephens**

How are you Amir?

**Amir Rozwadowski**

Well, John. I was wondering if we could talk a bit about the standalone OTT offerings. You had mentioned in your prepare commentary that you have had some progress with the content partners. How should we think about the positioning of those offerings going forward in terms of potential opportunities set to either expand the addressable market for DIRECTV or, conversely, there have been some concerns that it could come in and cause some level of potential cannibalization for certain types of users. And then I've got a follow-up question, if I may.

**John Stephens**

Yes, So the AT&T now and the AT&T mobile are really specifically - the DTV Now, excuse me, the DTV mobile - the DTV Now is really expected to look and appear and have a channel choices very similar to what we have on the traditional subscription DTV product today. The attractiveness for us is that, yes, there is a market of 20 million households that don't have it today. There is a collection of, if you will, core nevers, young people who have never had their own subscription that they might be able to get this. And quite frankly, the cost efficiency of being able to deliver it without having the cost of installation of a satellite dish or possibly a set-top box - whatever the cost that may be eliminated out of this - are really attractive and make it something that not only could grow the customer base, but also can be a very reasonable profitability for us.

So, we believe that we are very excited about that opportunity, and it gives us a way to compete in different places, even those places where we don't

have the broadband product in place. So, we are excited about that. Right now, the people who buy our DIRECTV and U-verse video products are the high-end customers who generally want a subscription video product in their home, with three or four televisions connected, and that variation. So it is a slightly different marketplace or different customer base with regard to DIRECTV Now.

Likewise, we are excited about the opportunity to do it on mobility, and provide the DTV mobility to those customers who use mobile devices as their broadband alternative. With that being said, we are really excited about growing the market. And, at this time, we are excited about the ability to package a collection of content that is very similar to and very attractive to the customers that we would be targeting with this.

### **Amir Rozwadowski**

Thank you very much. And then just a quick follow-up, thinking about the cash flow generation capabilities of the company at this level, you had mentioned you feel like you are on track when it comes to the synergies associated with the DIRECTV integration. There have been other cost synergy or cost reduction initiatives ongoing at the company for some time now, be it Project Agile or other initiatives. How should we think about the opportunities for improving the cash generation capabilities of the combined entity?

### **John Stephens**

Real simply, the numbers we have out in public was our Project Agile initiatives, which are going quite well. We are about \$3 billion of annual cost efficiency, cash operating expense savings or cash savings. Our merger initiatives are \$1.5 billion a year or more, once they get up to the run rate. As you have seen, we've got software-defined networks which are really driving the opportunity to, if you will, reduce capital cost and reduce cash operating expenses from the ability to eliminate truck rolls and other installation costs.

When you roll those up, it's pretty easy to take those public numbers we have given and get to a number that is a \$4 billion or \$5 billion, \$6 billion opportunity, whatever totals you want to get to. That kind of opportunity is very exciting for us. We are striving and working very hard. If that is to occur, we will have a very strong opportunity over time to grow cash flow.

### **Amir Rozwadowski**

Great. Thank you very much for the incremental color.

## **John Stephens**

Sure.

## **Operator**

Thank you. We will go next to Michael Rollins with Citi Research. Please go ahead.

## **Michael Rollins**

Thanks. Just a couple of questions. First, can you give us an update on the initiatives that management discussed around deploying 40 megahertz of new spectrum to fuel capacity for the emerging video strategy and mobile broadband demand that you are seeing? And then secondly, if we can just an update on your thoughts more broadly on the strategy in Latin America, and how you perceive the need to [indiscernible], to either scale up or scale out of those markets over time? Thanks.

## **John Stephens**

So, with regard to – and I will stay away from anything with regard to the auction, as Mike mentioned at the first, can't make any comments with regard to that. Our overall spectrum plan, though, as you all know, we started the IP some years ago, and put in a lot of fiber in the ground and put LTE nationwide. It was our effort to have a network, and particularly a wireless network that had extremely strong backhaul capabilities, and would be built in a manner such that we could upgrade the technology rather easily, as new technologies came along.

With regard to having that network, it is a very dense network with macro towers, and as such, we are now in a position that with our 40 megahertz of WCS and AWS-3 spectrum, we are now in that position of taking that spectrum and rolling it out and putting it to use over top of this very high-quality, dense, fiber-rich network that we have already built. That allows us to deal with the capacity needs of our business for a long period of time and continue to then position us, as appropriate, to do software upgrades as we move onto the next group of technologies.

That allows us to deal with the capacity needs of our business for a long period of time, and continue to then position us, as appropriate, to do software upgrades as we move onto the next group of technologies. So we feel in a very good position and feel like the overall strategies that we started with some years ago with Project VIP, and getting the 300 million LTE POPs out there, and getting a fiber-rich backbone out there support the backhaul for the right decisions that are really paying off with this, as well as



the decisions we made to buy the WCS and buy the AWS-3 spectrums. They are really coming into value for us in a very significant way.

With regard to Latin America, as we mentioned in our comments, we mentioned before – tough environment, but the team down there, we have been impressed with, they are operating very well. Brazil is a challenging environment, both economically and politically. But the team is performing quite well and the overall profitability is impressing us for a management team to be able to operate in that environment and produce the results they are. We are focused not on customer accounts, but on profitable growth and quality.

And quite frankly, we are recently encouraged by the change in some of the exchange rates. If you look at where the Brazil real is today, at closer to 3.5, you can look at where the Argentine peso is at 14.5; and even some improvements, quite frankly, in Mexico and the peso coming up, we are starting to see some light. It's very early, and so we will continue to work very hard to improve operating results. We will keep flexibility with it. We are impressed with the teams that are there. We're going to keep working hard to make it the best business we can.

**Michael Rollins**

Thank you.

**John Stephens**

Sure, Mike. Thank you.

**Operator**

Thank you. Our next question is from Tim Horan with Oppenheimer. Please go ahead.

**Tim Horan**

I wanted to focus on the handsets a little bit more. Do you think the quality of the handsets have gotten better, so that the life can be extended here? And do you think customers are going to look to save money on handsets? And if so, can we see some elasticity in terms of service spending with you guys a little bit more? Thanks.

**John Stephens**

Tim, the first thing is, to your first point, on the quality – I do think that is part of it. But what I also think is, if you will, the BYOD aspect of our business, we've seen significant increases in those numbers since we started

the equipment installment plan or the Next program. And so I think there were a lot of phones that were still very operable, very good shape, that were in, quite frankly, that were idle in the drawer, so to speak. And I think we've seen the reuse of those phones extensively. We have seen our BYOD numbers grow from 80,000 to 90,000 a quarter, some years ago, to 400,000 or more in a quarter. So I think your point on that is best exemplified or best described by that.

With that being said, I think when consumers get the choice and understand that they are making spending decisions with their money, they are going to be very efficient. Last, I think that there are – it's a fluid market; and there is, quite frankly, developing a lot of quality, lower-cost handsets. We are seeing that really in our prepaid business extensively, where there is a lot of good quality smartphones that are much lower per-unit cost. All of those things are impacting the marketplace, and they are impacting our equipment revenues, but they are impacting our equipment expenses. And as both of those go down, we certainly are striving to have the opportunity to have the customer continue to reinvest some of those savings in our services. And we will strive to continue to do that. We will see how that plays out. In the first quarter, we did have good, solid performance in our wireless service revenues. We are extremely encouraged by that.

**Tim Horan**

Thank you.

**John Stephens**

Thank you, Tim.

**Operator**

Thank you. We now have a question from Brett Feldman with Goldman Sachs. Please go ahead.

**Brett Feldman**

Thanks, two quick ones, one just coming to cash flow, and a statement you made earlier in your remarks about seasonality of payables. It looks like you used about \$4 billion cash on payables. And I was just hoping we would get some color on how to think about working capital items impacting cash flow for the balance of the year. And then the 3 million subs who took the unlimited wireless plan, a lot of them were existing customers. It is generally ARPU accretive when the customers move into the unlimited plan? And since it is still ongoing, should we view that as a source of ARPU stability going forward?

**John Stephens**

Good question, Brett. I think, Brett, you're looking at the cash flow statement and you're looking at that change in accounts payable. It was about a \$1.8 billion impact last year for the first quarter and about a \$4 billion impact this year. And you are looking at the right numbers. The reason that increased was twofold. We had the opportunity to invest a lot of CapEx. There's a lot of equipment and a lot of inventory in the fourth quarter at very good prices and rates, and satisfying contractual commitments. Those things turn around and get paid for in the first quarter.

With that being said, we think that is a timing item, and we don't think it will have a permanent impact for the year. It will just reverse out as we go through, so that is it. We bought up some inventory, enhanced that to the other items, and we made some investments in equipment. So that is that aspect of it. That is why we are encouraged about free cash flow not only meeting guidance, but actually growing year-over-year.

Secondly, the 3 million subs are mostly existing subs. And initial times where that – many of them brought not only their device, their handsets, but their tablets with them, and there was some positive impact for those who did bring those tablets. We are encouraged by that. We are optimistic about that. But we are going to be very patient and careful about that to see how that plays out. We did, though, get some new video customers out of this. And I won't suggest it was a significant amount of the 3 million, but we did get some new ones. And we are also very encouraged about that. And we are learning from that to find out how we might be able to make that a more – grow that addition of video customers even more through these types of offerings. So, positive on both ends of your questions.

**Brett Feldman**

Okay. Thank you.

**John Stephens**

Sure.

**Operator**

Thank you. We now have a question from Simon Flannery with Morgan Stanley. Go-ahead please.

**Simon Flannery**

Thanks a lot, John. You touched on GigaPower and the attach rates for your broadband. Can you just update us on the build out or is that going to be fairly linear? Where do you stand today in sort of the FCC commitments? And going back to the 2G decommissioning, perhaps you can just let us know how much spectrum is tied up in 2G that will get freed up by this initiative? Thanks.

### **John Stephens**

Thank you, Simon. On the GigaPower, I think we are at 1.6 million fiber-to-the-prem locations that are active and running today. We are on track with our FCC commitments and are confident we are going to meet those on a timely basis. And included in our CapEx plans for this year, and our longer-term multiyear plans includes fully funding all that activity, so we are optimistic about that.

With regard to the 2G commissioning, the one item I want to make sure I am straightforward with is as the volume of data traffic or volume of traffic on the wireless network has gone down from 2G devices, we have been, if you will, taking parts of that spectrum and repurposing it as we go. So, in some markets, we may only have a 2 by 5 slice of spectrum left to repurpose. So we have been doing that, if you will, so to speak, ratably or as we go as we have been able to free up spectrum.

So there is more spectrum to free up. I don't have the specific numbers at my disposal, here, Simon. But I will tell you, even with that, there still is a lot of cost that are left just to operate even a piece of the 2G network. And so we are anxious to capture that savings and use it to continue a strong EBITDA story for our wireless business, and a story that is coming from good quality network operations and efficiency.

### **Simon Flannery**

Great, thank you.

### **John Stephens**

Thank you

### **Operator**

Thank you. Our next question will come from Frank Louthan with Raymond James. Go-ahead please.

### **Frank Louthan**

Great. Thank you. Can you give us a little update, as you have been making the transition between the U-verse customers there, what is sort of the cannibalization rate between some of the DIRECTV and the wireline U-verse? And the same thing on the broadband, are you seeing a shift more to taking advantage more of the GigaPower and away from DSL? How much of that is just losing share?

**John Stephens**

Yes, Frank. Thanks for the question. On the broadband side, Frank, we are through most of the opportunity of where they have DSL and also have the choice of either GigaPower or high-speed broadband products. About 95% have already transferred. So we have got some left. The rest of it is just a legacy DSL footprint. We will continue to support those. We will continue to try to provide good service to those customers. But, if you will, that trade-off has – the team has worked hard to get people to upgrade into speeds and to take advantage of our better-quality products and services. I think of that as a success.

With regard to U-verse and DIRECTV, it is really the focus has not been so much about cannibalization as it is that the sales channel has been focusing on selling DTV satellite service. And the reason is, is because it is a lower cost structure. We can get, if you will, the content synergy savings by adding the customer there. So, that's really what's going on. It's not so much a cannibalization or a concerted effort, if you will, to shift. It is more of getting the new customers on DTV. And then in some cases, certainly, when we have same desk opportunities, one of the ways we can do it is getting onto the lower cost structure. So, that is really the focus. We still get good Net Promoter Scores and good quality scores on both the DTV and the U-verse platform, and we are still pleased to support both. I have U-verse in my own home, so it works very well for me.

**Frank Louthan**

All right, great. Thank you.

**Michael Viola**

Kathy, we will take one more question.

**Operator**

Thank you. That will come from Amy Young with Macquarie. Go-ahead please.

**Amy Yong**

Thanks. I was actually wondering if you could talk a little bit about your Mexico business. You had two quarters now of consecutive net add growth. What sort of trajectory should we expect going forward? I think in your commentary, you mentioned profitability improving in the back half of the year. What kind of metrics should we expect? Thank you.

### **John Stephens**

Thanks, Amy. We are not going to give specific guidance on customer accounts in Mexico, but we are excited about the progress we've made. And certainly when you have got two quarters in a row growing customers at this level, you want to keep that momentum going. I think the more important aspect on Mexico is this: one, we do expect at the end of this year we will have 75 million of the population covered with LTE. That will probably bring our total North American footprint to well over 390 million.

So we will be at essentially 400 million POPs by the end of this year, but certainly by 2018 on the North American footprint. That growth in LTE POPs then gives you the opportunity to expand your sales in other markets. Including in that is launching additional markets with an effective market strategy where we not only have the network, but we also have customer care, customer service, the AT&T brand, and acceptable distribution. And we will continue to grow that effective marketplace. We have got, if you will, markets launched of about 42 in Mexico today and we expect it to be up to 160 by the end of the year.

So you can see that getting the LTE to 75 million POPs, and getting the customer care service and the distribution at that same level is going to provide us a much greater opportunity than we have today and will give us some time to establish ourselves in those markets that we have just joined. So, you can understand why we are optimistic about it, and that we believe that the team is on the right track in doing that. It is a long-term investment for us. We believe highly in the market. And we think it is a natural addition to our North American operations, not only for wireless, but also for our business opportunities.