Operator

Ladies and gentlemen, thank you for standing by. Welcome to AT&T's Third Quarter 2018 Earnings Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. Instructions will be given at that time.

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

Michael J. Viola - AT&T, Inc.

Okay. Thanks, John. Good morning, everyone, and welcome to the Third Quarter Conference Call. As John had mentioned, I'm Mike Viola. I'm Head of Investor Relations here at AT&T. Joining me on the call today is, first, Randall Stephenson, AT&T's Chairman and CEO; John Stephens, AT&T's Chief Financial Officer; John Donovan, Chief Executive Officer of AT&T Communications; and John Stankey, the CEO of WarnerMedia.

Randall is going to provide some opening comments, turn it over to John Stephens, who is going to cover the consolidated segment results. Also he'll provide an update on our deleveraging plans. J.D. will give a business update for the Communications segment, including comments on FirstNet and 5G. And John Stankey is going to join us for the Q&A part of the call.

I'd also like to just update quickly on our upcoming analyst event. We now plan to do a video webcast, a single sell-side, buy-side meeting. It's going to be here in New York in the late afternoon of November 29. And so more details to that will come in the next few days.

Finally, I want to call your attention to our Safe Harbor statement before we begin. It says that some of the comments today may be forward-looking. As such, they're subject to risk and uncertainty. 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 auctions, 101 and 102, and so we can't address any questions about that today.

And as always, our earnings materials are available on the Investor Relations page of the AT&T website, and that includes our news release, 8-K, investor briefings, and associated schedules.

And so now I'd like to turn the call over to AT&T's Chairman and CEO, Randall Stephenson.

Randall L. Stephenson - AT&T, Inc.

Thanks, Mike, and good morning, everyone. Appreciate everybody joining us this morning. I'm going to be very brief before I hand it over to John Stephens.

But this year's results, everybody knows, has had a lot of noise in them. We've had a significant amount of M&A. We've had a number of accounting rule changes imposed on us. And the third quarter was obviously particularly impacted by it being the first full quarter with WarnerMedia results in it.

And just to cut through the clutter, what I typically would like to do is just go straight to the cash flows. And if you look at the cash flows for the quarter, I feel really good about the results. Our cash flow from operations was $12.3 billion for the quarter. That's up 14% year over year. And when you look at free cash flow, which is the cash available to pay dividends or pay down debt, that was a very healthy $6.5 billion, which is up 17% year over year.

And if you get beneath that, there's just a couple of areas that I think are worthy of pointing out. First is Mobility, and Mobility is growing. And that's significant because it's obviously our largest contributor to earnings and cash flow. And what I'd really point out is that growth is being heavily driven by our Prepaid business, which is running red-hot. And I think we're seeing Cricket truly begin to distinguish itself in the marketplace.

Then also when you look at WarnerMedia, all three divisions are growing. And WarnerMedia was immediately accretive in its first full quarter to the tune of $0.05 per share.

These strong cash flows have put us on track to hit our deleveraging objectives, getting to 2.5 times debt-to-EBITDA by year-end 2019.

And John Stephens is going to go into this in more detail. But what you're going to see is that we're going to exit this year with our debt maturities over four years old that are going to be at a very comfortable level as we exit this year.

And then last, we made a number of pricing moves on video. And we're getting near the end of our fiber build project, which is basically laying the foundation for stabilizing our broadband and TV business profits in 2019.

So across the business we – obviously we have a lot of work to do, a lot of integration efforts going on with WarnerMedia. But I like the momentum. I feel confident that we're on track to deliver the plans that we've laid out. And as Mike pointed out, we're going to just go through the quarter today.

But when we get together on November 29, we're going to give you a full blown look at our plans as we move into 2019 and beyond.

So with that, that's my high-level view on the quarter. And I'm going to turn it over now to John Stephens.

John J. Stephens - AT&T, Inc.

Thanks, Randall, and good morning, everyone. Thanks for being on the call with us this morning. Let me begin with our financial summary, which is on slide 3.

As we've done in previous quarters, we'll be referring to comparable results for most of our segments on the next few slides. AT&T adopted new accounting standards this year that deal with revenue recognition, certain pension costs, and certain cash receipts on installment receivables. These changes impact our income statements and cash flows on a reported basis. So at the same time the company made a policy decision to record universal service fees and other regulatory fees on a net basis.

So getting to it. Adjusted EPS was $0.90 per share, which was up more than 20% for the quarter and up 18% year to date. Tax reform continues to have a positive impact on EPS, as does adoption of revenue recognition standards as well as the full quarter impact of WarnerMedia.

Earnings were pressured by strong smartphone volumes with the launch of the iPhone XS as well as some foreign exchange pressure, especially in our VRIO and WarnerMedia operations. We continue to expect adjusted earnings per share growth at the upper end of the $3.50 range. The fourth quarter has traditional seasonal Wireless pressure. But our strong third quarter iPhone volumes and WarnerMedia will ease that impact.

Consolidated revenues came in at $45.7 billion, up 15%, thanks mostly to the Time Warner acquisition. When you look on a comparative basis and without Time Warner, revenues were essentially flat year over year. Gains in Wireless and Xandr, our new advertising segment, were offset by declines in legacy services, the impact of transition in our video business, and foreign exchange pressure.

Adjusted consolidated operating margins in the quarter were up year over year as reported and on a comparable basis. The addition of WarnerMedia provides margin support, but solid smartphone sales did drive some pressure. The biggest margin pressure continues to be because we're transitioning from linear to over-the-top video.

Our cash from operations and free cash flow continue to be strong as Randall pointed out. Free cash flow was $6.5 billion in the quarter and $14.4 billion year to date. This is even more impressive when you consider capital spending of $5.9 billion with no reimbursement of FirstNet costs in the quarter.

We continue to expect our capital spending in the $22 billion range this year. But we don't expect as much vendor financing in the fourth quarter as before. So now we expect to be in the $24 billion range in gross capital investment for the year.

We're feeling really good about our free cash flow position heading into the fourth quarter. We expect $1.3 billion of FirstNet reimbursements in the fourth quarter, since we've received the FirstNet authority's approval for the latest contract milestone achievement.

We also have another full quarter of free cash flow from WarnerMedia. And when you consider last fourth quarter's free cash flow of $4.5 billion, remember it included $1 billion of employee-related payments, including employee tax reform bonuses and some benefit funding plans.

When you take this all together, you can see how this gives us growing confidence in our cash position as we move forward. Our ability to generate strong free cash flow is a critical part of our strategy and gives us the financial strength to both invest in the business and improve our leverage position.

Let's now talk segment results, starting with our Communications segment, which consists of Mobility, Entertainment Group, and Business Wireline units. That information is on slide 4.

The tide definitely turned in Wireless. Postpaid phone growth continues. Prepaid had its second best phone net add quarter in more than 10 years, and service revenues grew by more than 2%. Total Wireless revenues were up more than 5%, thanks in part to higher equipment revenues.

Postpaid phone net adds continued its year-over-year improvement, adding 69,000 subscribers. That's the tenth consecutive quarter of year-over-year improvement.

Prepaid added another 570,000 subscribers with 481,000 of those being prepaid phones. Strong sales did pressure margins, where we sold 700,000 more postpaid iPhones this year than last. But we grew EBITDA, and our service margin was still solid, coming in at about 50%.

Moving over to our Entertainment Group, we continue to see the impact of the video transition on our revenues and margins. We told you last quarter that we expect revenue EBITDA pressure to continue the rest of the year. And recently Randall talked about stabilizing the business next year. Revenues did improve sequentially in the quarter, but some of the margin pressure continued.

Third quarter EBITDA comparisons were also pressured by an additional week of NFL SUNDAY TICKET games, which we'll get back with one less week in the fourth quarter, and last year's Mayweather/McGregor event, which was a record-setting event. Without those pressures, EBITDA was down about 14% year over year, an improvement from the second quarter decline.

We still have a lot of work to do, but we are committed to stabilizing EBITDA in 2019. John Donovan will provide more details on how we'll get to Entertainment Group EBITDA stability next year. But you can see the impact of some of the first steps we are taking in our third quarter results.

DIRECTV NOW net adds were 49,000. We've been very successful in building our over-the-top subscriber base. Now we're focusing on improving profitability; scaled back our promotions and special offers. We also moved toward market pricing in the quarter. We expected net adds to be impacted by these actions, and they were. But subscriber growth in the quarter exceeded our expectations.

Traditional TV subs continue to decline but at a slower rate than last year. U-verse improved, but we continue to see declines in DIRECTV subscribers. DTV subscribers were impacted by a 32,000 customer loss due to the elimination of our prepaid video product in Puerto Rico.

In Business Wireline, we continue to improve margins through cost efficiencies. Margins were up on a comparable basis, as these cost efficiencies offset legacy revenue declines. Part of the margin improvement and the revenue lift was from the realization of some intangible revenues in the quarter. But even without those revenues, margins were still up year over year.

Now let's look at WarnerMedia's third quarter results. Those are on slide 5. WarnerMedia had strong revenue growth with gains in all three business units. Higher subscription revenues at HBO and Turner and increased TV licensing revenues at Warner Bros. helped drive most of those gains.

Total WarnerMedia operating expenses were up year over year, primarily due to higher television production costs at Warner Bros., which were partially offset by expense declines at Turner and HBO.

In August, during our accounting call we estimated the amortization for Time Warner pre-acquisition, pre-release content was $600 million and would be included in segment EBITDA. Since then, we've done a lot more work, specifically on our purchase-price accounting efforts. And the amount amortized this quarter increased by about $200 million over what we expected to reach nearly $800 million in the quarter. But even with this additional $200 million charge, WarnerMedia EBITDA still grew.

Turner saw solid gains in subscription and content level revenues. Subscription revenues continue to grow, thanks to higher domestic rates and growth of Turner's international networks, even with some foreign exchange pressure.

Turner's advertising revenues declined 4%, or 3% excluding foreign exchange. Domestic ad revenues declined low single digits due to lower delivery across various Turner networks, primarily for kids and young adults. International ad revenues declined in the low double digits, reflecting pressure from foreign exchange rates.

Turner's operating income was up 13% reflecting revenue growth and a decline in operating expenses.

HBO also delivered solid subscription revenue growth in the quarter. Subscription revenues were up 7%, primarily due to higher domestic rates and subscriber gains in our national markets. Content and other revenues were down due to lower home entertainment and international licensing revenues.

HBO's operating income was up nearly 11% due to higher revenues and a decline in expenses.

Warner Bros. revenues grew nearly 8% in the quarter driven by higher television licensing revenues. Television revenues increased primarily due to higher licensing and initial telecast revenues, driven in part by the number of Warner Bros.-produced TV series. The actual revenues were mostly flat, which was quite an accomplishment considering the tough comparison to the year-ago third quarter.

Television licensing and films and a strong box office slate with hit releases such as Crazy Rich Asians, The Meg, and The Nun mostly offset the challenging theatrical slate and home entertainment release comps from a year ago.

Warner Bros. operating income was essentially stable, as higher revenues were offset by higher costs, primarily due to the higher TV productions.

WarnerMedia companies also continue to be recognized for their excellence in producing high-quality entertainment content. HBO, Turner, and Warner Bros. scored another impressive performance at the Emmys with WarnerMedia coming away with 37 primetime Emmy wins. And Turner and HBO added another 12 news and documentary Emmy Awards as well. CNN got six of those. I think that was a record for them.

Now let's look at our Latin America and Xandr results on slide 6. Total Latin America revenues and EBITDA were down year over year, primarily due to foreign exchange. Without the foreign exchange impact, revenues would have grown 5% on a comparable basis.

Subscriber growth continues to be strong in Mexico. We added more than 900,000 new subscribers and more than 3.5 million in the past year. We now have more than 17 million subscribers in total.

Service revenue in Mexico was down largely due to the decision we made in the first quarter to shut down the wholesale business that we inherited from Nextel as well as some FX pressure. Without those impact, service revenues would have been up year over year. While FX did impact our Latin America satellite operations, the business continues to be profitable and generate cash.

During the quarter, we launched Xandr, our new advertising and analytics business. And you can understand our enthusiasm for this business when you look at the results. Revenues were up more than 30% this year, partly due to our acquisition of AppNexus in the quarter. But even when you take AppNexus out, revenues were up 22% with EBITDA growing by more than 15%.

We believe we're just scratching the surface here. You can see what a difference targeted advertising makes when you look at the difference in the growth rates between AdWorks and Turner.

We're excited about the opportunity to apply our advertising technology to the Turner inventory. All together we have about $7 billion of consolidated annual ad revenues with a portion of that being addressable, highly targeted advertising.

AppNexus adds to our analytical capabilities even more and is a critical step in building our digital advertising marketplace. We'll talk more about this during our analyst meeting next month.

And now I'd like to turn the call over to John Donovan, who will provide an update on our Communications business. John?

John M. Donovan - AT&T, Inc.

Thanks, John. Now before we get to your questions, I'd like to take a moment to provide an update – oh, sorry. Thanks, John. I'd like to spend the next few minutes updating you on our priorities as we close this year and head into 2019. That includes building on our momentum in Wireless, expanding our fiber footprint, managing our video transition, and executing on our FirstNet deployment, and lastly, building on our lead in 5G.

Let me begin with our Mobility business. As John told you, the Mobility business delivered strong results in the third quarter. After four years of industry transformation, we've turned a corner with service revenue growth. I'm confident in our momentum as we finish off the year.

We continue to focus on quality phone net adds, both prepaid and postpaid, and saw year-over-year success with both in the third quarter. As John mentioned, this is our tenth consecutive quarter of year-over-year improvement in postpaid phone net adds. And we had the second highest prepaid phone net add quarter in more than 10 years.

We continue to be impressed with our prepaid customer base. Our prepaid business has very strong margins with a revenue stream that's growing at almost 7% year over year. From a pure value perspective, they look very similar to some of our postpaid base. In fact, through the first three quarters of the year, about 60% of our Cricket net adds have characteristics that would generate similar value that we see out of some of our postpaid customers.

Moving to the video business. We continue to navigate industry pressure. We have plans to bring EBITDA stability back to our Entertainment Group. Allow me to elaborate on that.

First, we're refining our four video products, tailoring them to customer needs. Our mobility-focused WatchTV is gaining traction. DIRECTV NOW is being updated to increase its simplicity and further differentiate the service. And our premium DIRECTV and U-verse services focus on the traditional linear TV viewers.

We've also begun beta testing our proprietary thin client streaming service and plan to roll out trials in the first half of next year. This will be a more measured roll out. And like our introduction of WatchTV, we expect this service to be EBITDA positive. And over time, it should lower our acquisition cost of our premium video service. And both of these use the common platform we introduced with DIRECTV NOW.

Second, we made the strategic decision to rationalize our promotions and special offers for DIRECTV NOW. We're taking a more tailored, data driven approach. Specifically, we focused on reducing promotions for low value, high churn customers.

Since launching DIRECTV NOW, we've learned a lot from our nearly 2 million subscribers about price elasticity and customer behavior with the virtual MVPD services. For example, we see customer behavior evolving somewhat like Wireless, with some customers seasonally shopping for shows.

We know our customer base now. And with our data, we'll continue to tweak our approach to optimize profitability and see our value proposition stabilize. This puts us in a more stable position as we set up a product realignment in 2019.

Thirdly, we're evaluating our program lineup. Content is the largest and fastest-growing cost of any video offering. We're evaluating our channel lineups and taking a fresh look at how we can align content cost with the price. It's also about what customers want. And many want smaller, value-based video packages.

And fourth, the two-year price lock promotion for DIRECTV and U-verse is being lapped. This gives us additional ARPU growth going forward and significant margin relief through 2019.

Another way we're working to improve Entertainment Group EBITDA is by driving broadband growth in our fiber footprint. We now cover more than 10 million customer locations today and plan to add 4 million more locations in the next year. We already have substantially more than 3 million broadband customers in our fiber footprint. And the longer we have fiber in the market, the higher our penetration.

In fact, we expect our fiber broadband base to increase by more than 1 million subscribers this year. This shift to fiber is beginning to drive IP broadband ARPU growth. The strategic pivot we're making with video, combined with our execution with fiber gives us the confidence that we will stabilize Entertainment Group EBITDA next year.

Finally, we're keeping a laser focus on costs in all of our businesses and maintaining our margins in Business Wireline.

Let's now move to an update on our FirstNet deployment, which is on slide 9. Our FirstNet team continues to execute extremely well. So far, we launched a nationwide FirstNet dedicated and physically separate network core with FirstNet traffic moving on it. We have priority and pre-emption in place, allowing continuous service during times of heavy traffic.

FirstNet devices are ready and available. These devices support all AT&T commercial LTE bands as well as the FirstNet Band 14 and meet the band priority selection technical requirements. And we're six months ahead of schedule with our network deployment already covering about one-third of the expected FirstNet area.

We're seeing in real time how we are performing in times of emergency with Hurricane Michael being the latest example. We began preparing for this storm before it arrived and our work continues even to today.

Because of these efforts, we were able to keep our customers, including first responders, connected during and after the storm in many areas. In fact, our network operated at 90%, and usually better, of normal performance in the areas affected by Hurricane Michael. And through our tight coordination with public safety, we rolled out network assets to impacted areas to keep first responders connected.

We also worked with local authorities to identify public safety agencies that were without service from their wireless provider and delivered hundreds of FirstNet-enabled devices to help these first responders carry out their important mission of keeping the public safe.

One first responder went as far to say, when everything else was down, FirstNet was working. That's high praise, and we're humbled that we can play a part in helping a community recover from such a devastating storm. That's what FirstNet is all about.

We continue to push our deployment. We're climbing towers and adding 700 megahertz, AWS, and WCS spectrum all at once. We're also adding new radio capability, which will enable us to upgrade the tower to 5G, without another tower climb.

The first responder community is a great sales opportunity for us. It's an area where we've been under-penetrated in the past. But with our dedicated network core and outstanding performance when it matters most to the first responders, we're making headway.

We now have more than 250,000 subscribers on FirstNet with more than 3,600 agencies represented. With a sales team dedicated to building this base, we believe there's a lot of opportunity waiting for us.

Now I'd like to talk about our leadership in 5G, which is on slide 10. AT&T is on track to be the first wireless carrier to introduce mobile 5G services in the United States in the next few weeks. This will be standards-based 5G. We plan to introduce 5G in parts of 12 cities by the end of the year. And we've announced additional 5G cities for next year, as we drive toward nationwide coverage of our 5G network.

Second, our 5G foundation is in place. We've completed 5G trials in several cities in the last three years. Fiber is the backbone of 5G, and we have one of the nation's largest fiber networks. Including businesses, we pass about 18 million customer locations today and are expanding that to more than 22 million locations by next year.

We plan for our 5G Evolution to be in more than 400 markets by the end of this year with nationwide coverage by mid-2019. Customers are seeing a dramatic lift in speeds with theoretical peak speeds reaching 400 megabits per second.

We also plan to launch LTE Licensed Assisted Access, or LTE-LAA, in parts of 24 cities by the end of the year. These are the building blocks towards the transition to 5G and can deliver speeds substantially faster than traditional LTE.

We're also the leader in software defined networking and are on track with our virtualization goals. This virtualization is bringing baseband units to the edge of the cloud or core and is going to be key for ultra-low latency that's in 5G.

Thanks in part to our FirstNet build, our fallow spectrum is being put into service at a rapid rate. We're on track to increase the amount of spectrum deployed by nearly 50%.

This is having a dramatic positive impact on our network, and others are noticing. We've been named the nation's best network by a September GWS OneScore study, which is the largest and most comprehensive network study of its kind. Our network already is a recognized leader, and we're taking steps to make it even better.

With that, I'll turn it back over to you, John.

John J. Stephens - AT&T, Inc.

Thanks, John. Now before we get to your questions, I'd like to take a moment to provide an update on our deleveraging plans. Those are on slide 12.

You know the commitments we've made. We plan to get to the 2.9 times range by the end of this year, drop that even lower by the end of next year to the 2.5 times range, and then return to historical levels by year-end 2022.

One big way we plan to accomplish that is through free cash flow growth. Our strong third quarter cash from operations and free cash flow results points to our ability to do just that.

We also continue to look for ways to monetize our large asset portfolio. We made several such moves in recent years, most recently the sale of our data centers and our under-utilized spectrum, combined generating over a couple billion dollars of proceeds. And we've identified billions of dollars of other assets where we can do more. So this is an ongoing process.

Our merger synergies will also help contribute, and they remain on target, $1.5 billion in cost synergies and $1 billion in revenue related synergies on a run rate basis by the end of 2021.

In addition, capital market options will be under consideration – or quite frankly, are under consideration. All options will be evaluated. We're going into diverse markets and looking at diverse investor bases. We'll consider make whole calls, tenders, as well as any other efficient capital alternatives. We've got that work going on now.

You can see how we are at managing our debt maturities by looking at what we've accomplished just since the merger closed. Since we've closed the deal, we've managed to spread maturity towers very effectively and expect to retire or refinance $28 billion of near- to intermediate-term maturities by the end of the year.

As you can see from our schedule, we've done most of that already. We've done this with cash on hand at the time of the close and utilizing diverse capital markets over the last four months. Our debt towers will look much different, resulting in very manageable annual debt payments.

We also have been able to lock in a portion of our debt into historically low interest rates. About 90% of our market debt is fixed rate, protecting us from rising interest rates. And when rates do rise, as they have in recent months, we have a natural hedge with our pension and benefit plans.

Simply put, a 1% increase in the discount rate today will decrease our pension plan liabilities by about $5 billion, so a very effective economic hedge.

Bottom line, our financial strength allows us to achieve our leverage targets and continue to invest in our business and return value to shareholders.

With that, I think we're ready to take your questions.

Michael J. Viola - AT&T, Inc.

John, go ahead.

Question-and-Answer Session

Operator

Thank you. And first, we'll go to the line of Simon Flannery with Morgan Stanley. Please go ahead.

Simon Flannery - Morgan Stanley & Co. LLC

Thank you very much. Good morning. So, Randall, I think recently you talked about the free cash flow as part of the deleveraging, getting to a $25 billion floor, the value exiting 2018. I wonder if you could just elaborate on what's driving that? And how you see that evolving over the course of 2019? Thanks.

Randall L. Stephenson - AT&T, Inc.

Sure. Hi, Simon. Thanks.

Simon Flannery - Morgan Stanley & Co. LLC

Morning.

Randall L. Stephenson - AT&T, Inc.

Yeah, what I said through I think it was last month was that we had told The Street, we had told everybody we would do $21 billion-plus this year in free cash flow. And that includes $2 billion of merger costs associated with the Time Warner deal.

And so the $21 billion, plus the $2 billion, which doesn't recur next year, puts you at $23 billion. And that all – the $21 billion also only included a couple billion, $2 billion of Time Warner cash flow. So you put Time Warner in for a full year, you get to $25 billion exiting this year as a run rate.

Now if you just kind of want to test that number, if you look at the first quarter we just posted here, in terms of what our free cash flow was for this quarter at $6.5 billion, annualize that, and you're at a $26 billion-plus kind of run rate number.

And so just to kind of help you simplistically understand how you get to a $25 billion number, that's kind of the path that we're on right now. And that assumes no growth in our Mobility business. It assumes no growth in WarnerMedia.

We assume that we keep the Mobility business growing. We assume that we get the Entertainment Group, our broadband and TV business to stable next year, whereas right now it's declining on an EBITDA basis double digits. And then you get Mexico from an EBITDA dilution standpoint this year to we think we can get this thing to break even or positive next year.

So you put all that together, we get good EBITDA growth, which should drive cash flow growth. And so $25 billion is just a comfortable number that I put out there. And we're actually on a run rate that looks better than that now.

John J. Stephens - AT&T, Inc.

Yeah, Randall, just if I can (36:23) add to that, we're really far along on our 12.5 million [customer locations] fiber-to-the-prem commitment out of the DTV transaction. That'll be done some time around the middle of the year, has to be. So we have a support there for a capital management, capital spend management.

Secondly, we've essentially completed the Mexico 100 million LTE build. We're just about right there on the edge. So once again, that'll give us an opportunity to hedge that.

Third, the FirstNet team and the network team working with them have been remarkable. They're well ahead of the targeted builds. We spent money to do that, close to a $0.5 billion, a little bit over $0.5 billion this quarter that we weren't reimbursed for.

And so that bodes well for us as we have had our milestones approved and expect to receive $1.3 billion in proceeds, reimbursements for that contract this quarter. So all of those things are what are building this momentum about strong cash flows.

Randall L. Stephenson - AT&T, Inc.

I think it's important too to take what John said and I said about where we exit the year in terms of free cash flow. And then pair that with that last schedule John Stephens walked you through on our debt maturities.

We will exit this year with average annual debt maturities for the next four years of $12 billion, well within the free cash flow less dividend range. And so we feel like we've got it stacked up where the debt is very manageable. We can get to these deleveraging targets that John spoke of. And I think it's stacked up well right now.

Simon Flannery - Morgan Stanley & Co. LLC

Great. Thanks for the color.

Randall L. Stephenson - AT&T, Inc.

Thank you.

John J. Stephens - AT&T, Inc.

Thanks, Simon.

Michael J. Viola - AT&T, Inc.

Take the next question.

Operator

And we'll go to John Hodulik with UBS. Please go ahead.

John C. Hodulik - UBS Securities LLC

Okay. Thanks. Maybe for Randall, a broader question. You guys have voiced a lot of confidence in the financial performance, which we just heard, and the strategic vision of the company. But the market's clearly not giving you credit for a lot of these things.

As you talk to investors, what do you think it is that the market's missing? Is it what you just went over there, the cash flow profile of the company versus the debt? Or if you could just sort of – what do you think is missing from the equation, given the performance of the stock?

Randall L. Stephenson - AT&T, Inc.

I think in terms of missing from the equation, I feel like we're tracking on plan right now, John.

As I pointed out earlier, the debt is very manageable. I'm very comfortable with the debt, the deleveraging, and getting down to 2.5 times by end of year next year. I think the cash flow characteristics of the business today already have us there. And that assumes that we have no further growth in 2019 in terms of our cash and our EBITDA. Cash flow is growing at a 14% year-over-year pace.

And so I think what we're going to have to just demonstrate to the market is continued performance in the Mobility side of the business. I think we have very good momentum.

As I mentioned on the prepaid side, Cricket is just defining that category and doing incredibly well. And that's an incredibly profitable customer base that we're building there and doing very well. The postpaid is doing well. ARPUs are growing in Mobility. And EBITDA looks really good.

And so if we can get this, the Entertainment Group, which is our broadband and our TV business, to stability, and we get Mexico to EBITDA neutral, to even EBITDA growth next year, then you have an equation that looks like really good cash flow growth for the next three, four years.

And so I think what we have to do is continue executing and posting quarters. I actually am pleased with this quarter. And we continue to do this, I think the markets will reflect that.

John C. Hodulik - UBS Securities LLC

And is EBITDA growth a part of that story? I mean, just it declined about 2.2% this quarter. Last quarter it was down about 5%, which is a nice trajectory to be on. Do you expect that trajectory to continue?

Randall L. Stephenson - AT&T, Inc.

Yeah, look, I mean, the EBITDA is driven by our Mobility business. And so can we get the Mobility business to good solid EBITDA growth? And I'll let John Donovan provide more color on that.

But I think we have a high degree of confidence that we can get Mobility to EBITDA growth. And so, yeah, to answer your question, we need to demonstrate sustained EBITDA growth on the company.

WarnerMedia, I mean you're seeing EBITDA growth today. Mobility, you're seeing us at EBITDA growth. Can we extend the Mobility EBITDA growth and get Entertainment Group to flat? Then there's your recipe for EBITDA growth. John, would you like to add any color on the Entertainment Group?

John M. Donovan - AT&T, Inc.

I'd love to. So if you look at the components of the Entertainment Group, what I think gets lost sometimes is it's a broadband-led world out there right now. If you look at the broadband portfolio, our fiber footprint build has given us a lot of inventory to sell into.

If you look at the industry's rate of decline on linear video, you find that we're doing dramatically better than the industry where we have fiber footprint. We're doing dramatically better than the industry in churn and acquisition where we have 25 meg and greater.

Where our stress is is in the linear, in areas where we're priced with just the linear video. And we're going to have to take actions to continue to improve how we're doing there.

But with the fiber inventory that we've got coming online back half of this year, first part of next year, we have a lot of footprint to sell into. And within the quarter, not only do we have broadband ARPU growth, each month of the quarter got stronger. So we feel very good about where the broadband footprint is, in particular the fiber area. And that will help us with the video business, the linear video business.

Probably the most important thing to draw attention to is the transition of the video business within. And if I could take just a minute to talk through what we've done there.

We thought it important as a 25% market share player in linear video that we be prepared to own the customers in this transition. And so when we put together an OTT product, DIRECTV NOW, we wanted to catch our customers. And I mentioned to you on prior calls that a large portion of those customers were either coming from cable or were coming from cord-cutter categories.

So we now have enough experience there to know that that business is a little bit like the prepaid Wireless business. We have seasonal shoppers who are shopping for shows. It's very promotionally intensive for roughly a third of that base.

And we're going to continue to curate that portfolio in a way that allows us to become more profitable. So as you think about the profitability of the video portfolio, the full-service premium product is going to continue to be driven by footprint. We feel very good about how broadband assists us there.

We're going to take our learnings in DIRECTV NOW and be more discriminating about the content that's provided and the profitability of that content. And then for mobile-only, we've got WatchTV, which right out of the chute is a profitable product.

And so I would say that right now we're very well-positioned as we roll into 2019 to be confident that we're going to get EBITDA stability in the video portfolio alone. That coupled with the strength of broadband will give us a really good EG performance overall as we roll into 2019.

John C. Hodulik - UBS Securities LLC

Okay. Thanks for the color, guys.

Michael J. Viola - AT&T, Inc.

Thanks. Just can we take the next question, please?

Operator

We'll go to Phil Cusick with JPMorgan. Please go ahead.

Philip A. Cusick - JPMorgan

Thanks, guys. John Donovan, if I could follow-up on what you just said. Can you dig into more on the trends in linear and DIRECTV NOW this quarter? I think that we and other people were a little surprised by the numbers, given the commentary about resiliency in September in DIRECTV NOW, but you said it was better than expected. Was the sequential slowdown a gross add or mostly a churn challenge? Thanks.

John M. Donovan - AT&T, Inc.

Well, if you look within the portfolio of the base that we've got, a lot of you folks have done your analytics, done surveying, and it's shown that DIRECTV NOW product, generally, we have tremendous engagement.

But within DIRECTV NOW, it's a tale of two cities. It's folks that are just jumping from promotion to promotion and really spinning in the industry between us, Hulu Live, YouTube TV. And so what we're learning, where and who those customers are, what people are viewing.

And so we actually expected a far worse outcome than we had. Its resiliency we – when we raised pricing and took promotions off – we were not at all promotional or very, very limited promotions of that product overall. And then we started to shift our mix.

So what we're after is customers that are highly engaged, that find the product compelling and use it a lot. That will lend itself towards being able to be supplemented by an ad model over time. And so what we wanted is to secure that base. And that's what we're going to focus on.

So going forward, our own team forecasts the growth of the OTT category lower than I think a lot of the analyst community does. Because after a first big slug with the introduction of fulsome packages, we're starting to learn now the customer base that's using this.

And so if you look at linear TV, it's really going to be about broadband and how do we use broadband to lead ourselves into premium TV. And then get an OTT package that's well-suited to the people that are going to be the heavily engaged users.

That customer base that we burned off, if you will, in the third quarter, and that we may or may not going forward chase in any given quarter, is always available. It's very promotionally-sensitive and price-sensitive, so you can always go get that business when you find the economics to do it so – or advantageous as a result of, for instance, what you can do on ad-supported models.

And so we learned a lot about it. We've streamlined the content packages. We've changed the mix of customers we're taking in with a bias towards getting people that are heavily engaged, that are buying on the higher end of those OTT offers.

Michael J. Viola - AT&T, Inc.

Thanks, Phil. Go ahead, Phil.

Philip A. Cusick - JPMorgan

I was going to say, can I follow up once more on the question earlier? John, did you just say to expect stability in video EBITDA next year, as well as growth in broadband? So are you guiding us now to growing Entertainment EBITDA?

John M. Donovan - AT&T, Inc.

No. What we're saying is we expect to see stability in the Entertainment Group as total, fueled in part by our solid performance in broadband as we get the 14 million fiber-to-the-prem customers available to sell into.

So the broadband results, which we are optimistic about, will add to our ability to get to overall stability in the Entertainment Group.

Philip A. Cusick - JPMorgan

Great. Thank you.

Michael J. Viola - AT&T, Inc.

Next question.

Operator

We'll go to Amy Yong with Macquarie Research. Please go ahead.

Amy Yong - Macquarie Capital (USA), Inc.

Thank you and good morning. Maybe one on advertising. Can you talk a little bit more about Xandr? I think a lot of us have seen cable's JV (48:31) in the past. How are you thinking about this differently? What are you doing differently?

And I think you recently signed up Frontier and Altice. What's been the receptiveness with those two in terms of the ad community?

And then maybe as the last part of the question, how does this then shape your view on Entertainment EBITDA? Thanks.

John M. Donovan - AT&T, Inc.

So this is John. Let me try to take a stab at it and ask Randall to jump in. First of all, when we looked at our opportunities with regard to the data analytics and the information that we had available, as well as the advertising opportunity, the first thing was to go out and get a collection of talent that has been established at Xandr that can really give us different insights, different capabilities, and we've done that. The second piece was then to get the – and so and those included data analytics capabilities that are specifically talented towards or gifted towards the advertising space.

Secondly, you need to get the technology platform and the ability to continue to develop data driven products. AppNexus was key to that, not only with their supply side and demand side platforms, but quite frankly, with their core talent, which is their engineering group. That brings us engineers that have this capability and have dealt with this for a long time, a great experience there.

When you combine those assets then with the tremendous data we have from a 25 million customer base in the video space, when you combine that with a significant inventory of advertising slots, whether it's the Turner inventory slots, 14 minutes in an hour of TV, or the 2 minutes from DIRECTV, you have both the data and the inventory capabilities. That's what this is about.

We have started that process with AdWorks, specifically from the legacy DIRECTV. And you've seen those results, double digit revenue growth. The quarter was 22% without AppNexus, tremendous performance. And we're proving that it works in that linear TV space.

I think we had announcements with regard to a couple of the other, if you will, distributors joining with us with regard to this, both Altice and Frontier. So we're starting to get traction with some of our other participants in the industry that view the team and the resources and the capability as being highly attractive. We'll continue to work on those efforts.

But longer term, if you can continue to grow this and use this capability, it can provide so much flexibility on your – from your customer base on linear TV, on the DIRECTV NOW, and the over-the-top. Quite frankly, then moving it on to Wireless and other areas.

The reaction I think from the business community has been positive. The reaction from our advertisers, I think it's been generally positive. I think we need to – we will continue to focus on proving that we can do what we say we're going to do, which the team is certainly doing.

And the opportunities are bright, particularly if we can move towards similar results across our total inventory of ads as well as attract other participants to join with us to increase the overall quality. Randall, anything you'd like to add?

Randall L. Stephenson - AT&T, Inc.

I think you covered it quite well. We just – we could – we have a lot of confidence as we build the mechanical tools and put in place a marketplace where people can design campaigns, measure campaigns, and do it without a lot of human intervention, which is what AppNexus does today in the digital world.

As we stand that up, can this 22% growth that we're experiencing on just our DIRECTV inventory – and keep in mind, that 22% growth we saw on the DIRECTV inventory is on a subscriber base that's declining 3% year over year.

And so if the revenues are growing 22% on a declining subscriber base, does that translate into a more fulsome inventory over in Turner? And can you drive growth rates that look that attractive on the Turner side? We actually have a high degree of confidence we can. This will take time to put these tools in place and develop the capability. But we have a high to – we really have a high degree of confidence here. And we're very enthusiastic about this opportunity.

Michael J. Viola - AT&T, Inc.

Amy, I know you asked about the advertiser business. Did you have another question in there?

Amy Yong - Macquarie Capital (USA), Inc.

No, I actually wanted to just follow up and see if Xandr at all shapes your view on Entertainment EBITDA group's – and hitting stability? Thanks.

John M. Donovan - AT&T, Inc.

Yeah. And I think as John earlier covered, we're focused on improving that EBITDA trends and we're looking towards stability coming in 2019. And that's going to be both from the video strategy that John laid out and marketplace actions as well as continued improvement in broadband from our fiber-based products.

Randall L. Stephenson - AT&T, Inc.

I think the other thing, John, I would add is that – we mentioned it in the formal notes, is that two-year price locks that we have in place are rolling off. And the traditional linear video ARPU as a result of that can move to market pricing on most of the base. And us rolling past that is a really important lever for us going forward.

John M. Donovan - AT&T, Inc.

Even if the content costs continue to escalate at 10%.

Michael J. Viola - AT&T, Inc.

So next question if we could. Thank you, Amy.

Operator

We'll go to David Barden with Bank of America Merrill Lynch. Please go ahead.

David Barden - Bank of America Merrill Lynch

Hey, guys. Good morning. Thanks for taking the questions. I guess the first one for John Stephens on deleveraging. So, John, could you – two things I guess, two sub-parts.

Could you elaborate more specifically on kind of what assets specifically are of a large enough magnitude to be relevant to the deleveraging conversation? And also does the deleveraging target have an asterisk next to it relevant to spectrum spending? And ignoring the millimeter wave, things like CBRS and C-Band. Or are you guys comfortable with where you are spectrum-wise and you can focus exclusively on the deleveraging?

And then just a housekeeping item, kind of following up on Amy's question on advertising. I think advertising is kind of showing up in a lot of different places. It's being double counted in some other places. It's being eliminated in third places. So could you kind of just run through, John Stephens again, kind of where we're seeing advertising show up? And what's being reported where? Thanks so much.

John J. Stephens - AT&T, Inc.

Great. So let me take the last one first. Advertising is showing up at about a $400 million run rate. And just pure advertising in the AdWorks, the advertising segment, and that is from ads that are sold on the legacy TV, linear TV business, or in DIRECTV. So the revenue is showing up in advertising segment as well as about just under $6 a month on the customer base in the Entertainment Group. And then that is eliminated through company eliminations at the corporate segment.

Secondly, there's about $40 (56:12) worth of revenue this quarter from AppNexus. That's reported in the advertising business segment and only there.

Third, there is about – we run about $1 billion, or maybe it's a little bit less than that, this quarter in advertising in Turner, in WarnerMedia. That's reported there. That is not reported in the advertising segment because Turner manages that, WarnerMedia manages that internally.

And then what we do is we provide a supplement to show you a full picture of the advertising capabilities or revenue streams for the total of AT&T. And that supplemental adds those two numbers together and that's included in our disclosure sheet. So that's just an effort to make sure we give you full transparency with regard to what our total advertising is.

So that's how it's recorded. That's how it's reported and it gives you comparable information for DIRECTV compared to other participants in the TV industry, gives you the information appropriate for advertising, gives you the information appropriate for WarnerMedia, and how they compare to others in the media industry. So it's just an effort to make sure we give comparable data that you can utilize as you look at other companies.

David Barden - Bank of America Merrill Lynch

Great.

John J. Stephens - AT&T, Inc.

With regard to asterisks, there are no asterisks. The 2.5 [times] range, which means if we come in at 2.51 [times] or 2.52 [times], we're going to say we met our mark. That's what the range is about. It's not – it's about 2.51 [times], 2.52 [times] and we did our jobs. We're not that – we don't want to come across as being that precise or that forward knowing that we can predict that. But there's no asterisk with regard to, if you will, any asset purchases.

With regard to asset sales, I'd just say it this way. We go through the listing of real estate we have, and I know this sounds a little bit – if we go, for example, the new opportunities on credit process that came through the Tax Reform Act (sic) [Tax Cuts and Jobs Act] (58:14). We have real estate all over the country that falls into those. We have a whole different category of real estate sales that may qualify or may be interested on that. If you think about our administrative buildings and, quite frankly, across the total new AT&T, you've got a whole opportunity.

So I'm not going to get into any major transactions. Certainly, as you can imagine, that might not do anything to help the valuation process. But we're looking at everything. And needless to say, that total listed – total dollar amount of assets is material even for us, and we'll continue to work it and focus on it.

We got a great plan. We have cash from ops, managing CapEx as we go forward with so many of our projects getting completed. That generates great free cash flow and solid EBITDAs with merger synergies and improvement in our business, that we've got a great way to get there.

The asset sales are an additional way to make sure that we meet and exceed these goals. But no list of assets on this call today.

David Barden - Bank of America Merrill Lynch

Great. Thanks, John.

John J. Stephens - AT&T, Inc.

Sure.

Michael J. Viola - AT&T, Inc.

Okay. We'll take one more question.

Operator

And that will be from Matthew Niknam with Deutsche Bank. Please go ahead.

Matthew Niknam - Deutsche Bank Securities, Inc.

Great. Thanks for getting me in. I'll ask about Wireless. Can you help us think about the churn step-up in the quarter? Whether it was tied more to pricing actions or any sort of change in the competitive backdrop?

And then seasonally, I think there's been another step-up that you've typically seen in the fourth quarter. Do you anticipate another step-up off of the 0.93% that you saw this past quarter? Thanks.

John M. Donovan - AT&T, Inc.

Yeah, if we start with the revenue side of the formula, we feel pretty strongly that with the last four or five quarters of growth – and that's just not year-over-year improvement. When we go to absolute growth, you start to have that kick into the base of your revenue.

We took price action, so we expect the churn to tick up as a result of those price actions. And a lot of that has subsided now because the price actions occurred in late first and through the second quarter. And so we feel very good about where we are right now in both customer acquisitions.

And by the way, by the data that we looked at, if you take the third quarter, we believe we were the least promotional of all the carriers out there. And yet provided some good net growth on both the traditional postpaid business at Cricket, which you've heard a lot of excitement about today. So if you look at the total performance on phones, smartphones, we had a really good quarter. And we're starting to get growth out of Cricket. We're getting growth in the core business.

And we're the least promotional of all the carriers, both from the standpoint of when you look at our share of voice in advertising and the financial promotions, incentives for customers. So we're executing with things like stores and close rates and traffic-driving and putting – bundling up. That still continues to be a very effective acquisition tool.

So if you look at share of gross adds, and I'm sure you folks on the call here will run that, you start to look at how we've been doing. Our share, flow share in the business has improved dramatically year over year. And that's where the strength is coming from.

The last thing I'll say is that the iPhone launch is very different this year than last year. The sequencing of the more expensive device, the timing of availability of those, that difference does net into the results. So net of that, we feel that that business was a strong third quarter. And we're very confident in the momentum of that business going forward.

Randall L. Stephenson - AT&T, Inc.

So with that, again, thanks, everybody, for joining the call. And just as a recap, first full quarter with WarnerMedia under our belts. And we have cash flow growing nicely. Operating cash flow 14%, free cash flow 17%.

Mobility is back to growth and executing well. We feel really well about – really good about where it's headed into 2019. WarnerMedia executing very well, and the first full quarter is accretive to earnings by $0.05 a share.

And going to exit the year with our debt portfolio at a very reasonable place, deleveraging plans on track, getting to 2.5 times debt-to-EBITDA by the end of year next year.

So bottom line, we feel like we're stacking up well for 2019. And appreciate everybody joining us and look forward to seeing everybody on November 29 in New York. Thanks, again.