Operator

Ladies and gentlemen, thank you for standing by. Welcome to AT&T Fourth 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. [Operator Instructions] I'd also like to remind your that this conference is being recorded.

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

Michael Viola

Okay. Thanks, Lea. Good morning, everyone, and welcome to the fourth quarter conference call. As Willy said, I'm Mike Viola, Head of Investor Relations here at AT&T. Joining me on the call today is Randall Stephenson, AT&T's Chairman and CEO; John Stephens, AT&T's CFO.

Randall is going to provide an overall business update, as well as discuss our 2019 business initiatives. John's going to cover results along with the 2019 outlook and then we'll get to a Question-and-answer session.

Before we begin, need to call your attention to our Safe Harbor statement. It says that some of the comments today may be forward-looking. They're subject to risk and uncertainty and results may differ materially and I'd tell you that additional information is available on the Investor Relations website.

I also need to remind you that we're in a quiet period for the FCC spectrum auctions, 101 and 102, so we can't address any questions about that today.

So as always, our earnings materials are available on the Investor Relations website, includes our news release, 8-K, investor briefing, associated schedules, et cetera.

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

Randall Stephenson

Okay. Thanks, Mike. I'm going to start on Slide 4 of the deck with a brief overview and then I'm going to give some highlights for the past year. And I would characterize our results as basically doing exactly what we committed during our Analyst Day in November and in fact I would say we're ahead of schedule on each of our key priorities, and as we said our top priority for

2019 is driving down the debt from the Time Warner acquisition, and I couldn't be more pleased that how we close the year.

We generated record free cash flow of $7.9 billion in the fourth quarter with the dividend payout as a percent of free cash flow below 50%. Our full year free cash flow was also an all-time record even with near record capital spending. For the full year, our dividend payout as a percent of free cash flow was 60% and that allowed us to increase the dividend in December for the 35th consecutive year.

So while I'm pleased with our financial results for the quarter, we also feel good about the progress we made during 2018 on all of our strategic imperatives. First, we finally closed Time Warner and we have brought together the leaders in content and distribution and as committed this transaction has been accretive since day one. And as John is going to discuss shortly, WarnerMedia had a terrific fourth quarter.

We also launched Xandr, our advertising business and then following our acquisition of AppNexus, Brian Lesser and his team are integrating that platform, they're applying Xandr’s customer insights to Turner's ad inventory and with fourth quarter revenues growing at 26%, our enthusiasm around this opportunity is continuing to build.

In terms of our networks, our quality and performance are on a very strong trajectory. GWS named us the best network in the most comprehensive study that's been conducted. We introduced the first standards based mobile 5G network in parts of 12 cities last month and our first net deployments finished the year well ahead of schedule.

We also accelerated our fiber deployment and we now reach 11 million customer locations in addition to 8 million business locations. As a result, our broadband business grew by over 6% in the quarter and it's really important to note that this fiber deployment is foundational to our 5G network. And I would highlight a couple of other items on this slide.

First, strong wireless performance with growth in both revenue and EBITDA. WarnerMedia’s continued strong growth in revenue and margins. In our Latin American business which grew subscribers in Mexico and in Vrio. And last, our total company pro forma EBITDA grew by 7.2% for the quarter.

If you go to the next slide, you're going to see our key priorities for 2019, there is no surprises. It's what we discussed back in November and our top priority is to delever the balance sheet. We have strong operational momentum coming out of 2018 and this is going to allow us to reduce our debt and continue our strong record for paying dividends.

And it's important to note that we're doing all of this while investing at industry leading levels in fiber, 5G and FirstNet. We expect to continue growing wireless service revenues. The entertainment group that's obviously our heaviest lift for 2019 that we're on a path to stabilize EBITDA in 2019 and we're actually quite confident that you're going to see significant improvement in the first quarter.

The focus at WarnerMedia is delivering the merger synergies and continuing to build on our 2018 momentum and in the back half of the year we plan to launch a premium SVOD service that's featuring content from all of our WarnerMedia brands, specifically Warner Brothers, HBO and Turner.

And then last Xandr and it's quickly scaling its capabilities into the ad inventories of Turner, our mobility business and all of our TV and over the top product. So we're focused - that's what we're focused on 2019. We do feel very good about our ability to deliver in each of these areas.

And so with that, I'm now going to turn it over to our CFO, John Stephens and he'll take you through the results. So John.

John Stephens

Thanks, Randall. Good morning, everyone and thanks for being on the call. Let me begin with our financial summary which is on Slide 7. As we've done in previous quarters we'll be referring to comparable results for most of our segments for the next few slides.

For 2018 AT&T was required to adopt new accounting standards, that deal with revenue recognition, pension cost and instalment receivables. These changes impact our income statements and cash flows. At the same time the company made a policy decision to record universal service fees and other regulatory fees on that basis. And I'm happy to add this should be the last quarter we'll have to open the call this way, as we've rolled through a full year of these accounting changes.

Let me start with earnings, adjusted fourth quarter EPS was $0.86 up more than 10% for the quarter and more than 15% for the year. For the quarter, WarnerMedia's and Mobility's strong performance drove these results. The benefits from the adoption of revenue recognition standards was generally offset by a higher effective tax rate and foreign exchange pressures.

Consolidated Revenue came in at $48 billion, up 15%, thanks mostly to the acquisition of Time Warner. Gains in Mobility and WarnerMedia were offset by declines in legacy services, the impact of the transition in our video business and foreign exchange pressure from Latin America. On a comparable basis, fourth quarter wireless equipment revenue was down by $500 million year-over-year due to fewer smartphone sales.

When you look on a comparative pro forma basis revenues were down year-over-year due entirely to lower wireless equipment revenue and foreign exchange pressure. In fact, without those impacts revenues were positive.

Operating income showed solid growth and adjusted consolidated operating margins continued to expand up [450] [ph] basis points with strong growth in Mobility and WarnerMedia margins.

For the full year adjusted operating income margins grew by 220 basis points. That growth comes even with margin pressure from the customer transition in our video business.

One housekeeping item related to the Mobility preferred equity interest we contributed to our pension plan back in 2013, that preferred return about $140 million in the fourth quarter is now reflected in non-controlling interest on the income statement with an offset in other income.

Earnings and margins showed strong growth, but perhaps the best measure of our financial success is our cash flows where we turned in record results. Let's look at that on Slide 8.

Both our cash from operations and free cash flow hit record levels for the full year. This is really important. For a company that depends on strong cash flows to meet our business goals we need strong cash like we had this past year to invest in our business, to meet our commitments to delever and to continue our long and proud history of returning value to shareholders.

Free cash flow is a record $22.4 billion in 2018, that's up 36% with $7.9 billion of that coming in the fourth quarter. This does include a $1.3 billion receipt from our FirstNet contract and reflects our results in managing vendor payables, accounts receivable and a variety of other working capital efforts. It also includes the impact of a nearly $500 million of voluntary contributions to our benefit plans that we made in the fourth quarter.

That dropped our full year dividend payout ratio to 60% in 2018. The strong free cash flow comes with near record capital investment. Year in year out, we're a leader in capital investment in the US. 2018 was no different, as we invested nearly $23 billion if you include the FirstNet capital for which we were reimbursed.

Equally important to us is our ability to pay a strong dividend. Investors expect one from us, a strong free cash flows has allowed us to pay a solid dividend since we became a standalone company in 1983 and we have consistently raised that dividend for 35 years. Our ability to generate strong cash flow is also a critical part of our commitment to improve our leverage position.

Let me give you an update on that on Slide 9. You know our leverage commitments we made, our goal was to get to the 2.9 range by the end of '18. Well we did that by paying down about $9 billion since we closed the Time Warner deal. Our next goal is to drop that even lower to the 2.5 range by the end of this year.

Our strong free cash flow in 2018 gives us confidence we'll achieve our 2019 free cash flows and be able to significantly delever. We expect about $12 billion in free cash flow after dividends in '19. We've committed to use that to pay down debt. That alone will get us to the 2.6 range by the end of the year. We've also been very thoughtful in deliver it and finding ways to monetize our large asset portfolio.

We've made several moves in recent years. Most recently closing the $1.1 billion sale of our data centers and we've identified billions of dollars of other monetizeable assets.

We have a large amount of office buildings and raw land that we've identified for potential sale. Our Hulu investment is another opportunity with more than $500 billion in total assets we'll continue to look for ways to monetize our asset portfolio and keep you updated on our progress.

Our merger synergies will also contribute. They remain on target, $1.5 billion in cost, and $1 billion in revenue for a $2.5 billion run rate by the end of 2021. And bottom line, our financial strength allows to achieve our leverage targets, continue to invest in our business and continue to return solid dividends to our shareholders.

Let's now talk results starting with our communication segment. That information is on Slide 10. Communications segment which consists of our Mobility, entertainment and business wireline units. Together this segment grew EBITDA and expanded EBITDA margins by a 120 basis points, driven by great performance in Mobility. Obviously we were sharply focused on profitability last quarter and our Mobility results point to our success.

Service revenues grew by $400 million or nearly 3% in the quarter. EBITDA was up more than 13% or more than $800 million. And we had our highest ever fourth quarter EBITDA service margin of 48.6. That's up 450 basis points over last year and was driven by service revenue growth, disciplined promotions, lower volumes and continued cost improvement.

We were strategic with promotions able to turn them on and off quickly to effectively compete. We won't hesitate to be where we see an opportunity, especially for high value customers. But even with a strong performance we had 134,000 postpaid phone net adds in the quarter with 467,000 branded smartphones added to our base.

You also saw our cost discipline in our prepaid business. That includes holding the line against uneconomical equipment promotions by our competitors. Even with our spending discipline, prepaid phones grew in the quarter, thanks to the strength of cricket where we added about 240,000 subscribers which more than offset a loss from AT&T prepaid.

Prepaid revenue growth was solid and earlier this month cricket passed the 10 million subscriber mark, doubling our subscriber base since we acquired the company in 2014 and momentum continues to be strong. Please note about 60% of our cricket net ads have characteristics that generate value similar to what we see from many of our postpaid customers.

We also made significant strides in our network of evolution in the fourth quarter. Randall told you about our network leadership in 5G introduction. With the additional spectrum we're adding, carrier aggregation and other network improvements, 5G evolution is producing better speeds for our customers today when compared to standard LTE. Our first net deployment is reaching critical mass and providing a tailwind for our results.

Now let's look at our Entertainment Group results and the steps we're taking to bring EBITDA stability. Our year-over-year decline slowed by nearly $300 million and EBITDA growth rates showed a sequential improvement even in a seasonally pressured fourth quarter. This was driven primarily by a reduction in customers on a two year promotions in the fourth quarter, as well as improvement in DTV NOW profitability.

We expect revenue performance to continue throughout the year helping stabilize EBITDA in 2019. We are confident we will stabilize EBITDA this year and expect to see real improvement in year-over-year EBITDA results starting in the first quarter.

A more tailored data driven approach with promotions is making an impact. Six months ago we had half a million customers on highly discounted DIRECTV NOW offers, it generally offers that require the customer pay $10 a month for the service. At the end of the year essentially none of these customers remained on those officers.

Eliminating these promotions for low value, high churn customers clearly elevated subscriber losses of the quarter, but it had a positive impact on streaming ARPUs and lowered content costs. In fact DTV NOW ARPU was up about $10 sequentially from the third quarter.

Our fiber footprint continues to grow. We now passed more than 1 million customer locations with fiber and are on our way to hit the 40 million locations later this year. This will extend our fiber network to 22 million locations when include business. Subscribers on our fiber network increased by more than 1 million last year, driving the number of total broadband customers in our fiber footprint to substantially more than 3 million, and the longer we have fiber in the market the higher our penetration rates go.

This performance is helping drive broadband revenue growth, another key focus in our drive to EBITDA stability, and as always, we're laser focused on costs, all costs including content. That too will play a big role in stabilizing EBITDA.

Cost efficiencies of the story of business wireline, strategic business services continue to grow and at the 12 billion plus annualized business that helps offset the continuing legacy revenue declines. Our focus on cost initiatives allows us to deliver margins even with the legacy revenue declines.

Now let's look at WarnerMedia’s fourth quarter results. That information is on Slide 11. WarnerMedia revenues grew nearly 6% with double-digit operating income in all three business units. Warner Brothers are in the spotlight this quarter, it had a great cash generation year and saw growth across both its theatrical and television business.

We had a great theatrical fourth quarter on the back of a strong slate of movies, including Aquaman or Star is Born, Fantastic Beasts: The Crimes of Grindelwald, and The Mule. Aquaman past the 1 billion mark in global box office receipts to date and the critically acclaimed film a Star is Born has racked up eight Oscar nominations. This helped propel Warner Brothers to its best quarterly and full year operating income ever.

Turner saw solid gains in subscription revenues. Subscription revenues continue to grow thanks to higher domestic affiliate rates, that’s even with foreign exchange pressure at Turner's International Networks. Total Turner advertising rates continue to be solid even while ratings decline. Domestic ad revenues declined 6% due to lowered delivery across various Turner networks, primarily for kids and young adult. International ad revenues were essentially flat when adjusting for the foreign exchange pressure.

However Turner's operating income was up nearly 21%, reflecting solid expense control from solid management of programming and marketing expenses in the quarter.

HBO results were impacted by a carriage dispute, but still saw a double-digit operating income in the quarter. Subscription revenues down 3%, primarily due to dispute, without that dispute subscription revenues would have been up slightly. Content and other revenues rose 17% due to higher internationalizing revenues.

HBO’s operating income was up 29% due to a sharp focus on expense control and lower programming and distribution costs. Even with the ongoing carriage dispute, we expect HBO to grow revenues in 2019.

As a final note, WarnerMedia companies continue to be recognized for their excellence in producing high quality entertainment. WarnerMedia received 11 Academy Award nominations, including A for a Star is Born. This comes on top of four Golden Globe Awards earlier this month.

Now let's look at Xandr and Latin America results are on slide 12. Xandr, our new advertising and analytics business continues to execute at a high level. Total revenues were up 49% or 26% excluding AppNexus. Much of that growth can be attributed to a strong political ad season. But even without that revenues continue to grow significantly.

EBITDA grew 17% and EBITDA margins continue to be very strong. The integration of AppNexus is on track. AppNexus heads best-in-class technology and data capabilities that strengthen our premium advertising marketplace. We're moving quickly to integrate the Xandr marketplace across AT&T.

Much of AT&T’s programmatic spending is moving to the Xandr platform, driving efficiencies on how we activate campaigns. At the same time, our digital inventories enabled on our platform and with our data driving better yield and higher demand. We started making digital data available for Turner's ad inventory and we're optimistic about this opportunity. Xandr’s advanced advertising marketplace is built to power the industry with rich data, technology and talent.

Our success across AT&T gives distributors, publishers and buyers confidence to work with us. Already Altice and Frontier onboard and working - and we're working to add more. We power 2 billion of advertising spend through our digital platform, most of which is from third parties.

Moving to the international side of the business. Our Latin America operations had a strong subscriber growth quarter, but we continue to deal with foreign exchange pressures. Total Latin America revenues and EBITDA were down year-over-year, primarily due to foreign exchange. Without that foreign exchange impact and excluding Venezuela revenues would have grown 2% on a comparable basis.

In Mexico we had a million new subscribers and more than 3.2 million for the full year. We now have more than 18 million customers in total. Service revenues in Mexico were down largely due to the decision we made to shut down a wholesale business that we inherited from Nextel, as well as some FX pressure. Without those impacts service revenues were up year-over-year.

EBITDA was impacted by operation - higher operational expense including a significant amount of non-recurring items. In Pay TV, fourth quarter subscriber net ads were 198,000 with gains largely in the South Region. Total subscribers at the end of the quarter were 13.8 million. While FX did impact our Latin America satellite operations, the business continued to be profitable and generate cash.

Now let's look at our 2019 guidance on Slide 13. Our guidance remains unchanged from what we said in our November analyst meeting. Free cash flow will be our most important financial metric. We expect free cash flow to $26 billion range in 2019 and we'll keep our dividend payout ratio solid in high 50% range.

As we discussed earlier, we are tightly focused on achieving 2.5 times net debt to adjusted EBITDA range by the end of the year. We will also continue to expect to invest at high levels in our business with growth capital investment in the $23 million dollar range. That's before reducing that investment by the $1 billion of FirstNet spending, which we expect to be reimbursed for.

While we expect the year-over-year impact of the new revenue recognition standard to be a headwind to earnings, we still expect adjusted EPS growth in the low single digits for 2019. We expect our effective tax rate in 2019 to be approximately 23% excluding any one-time item.

That's our presentation. Now I'll turn it back to Mike for a question-and-answer session.

Michael Viola

Okay. We're ready for the questions and so Lea, if you can open up the lines and get started.

Question-and-Answer Session

Operator

Certainly. [Operator Instructions] Our first question is from line of John Hodulik with UBS. Please go ahead.

John Hodulik

Great. Thanks, guys. Can we talk a little bit about sub trends both in the entertainment space and the wireless space. Maybe just to feed off your comments on entertainment, it sounds like with the majority of those customers coming off promotions and now losses should - should really start to slow. But at the same time you've got some price ups on the satellite side. So is it fair to say that that those losses could increase in some color there. Also on the broadband side with the fiber buildout, what do you expect in terms of trends there as we look out into ’19?

And then maybe on wireless, just wondering if in your view, you saw some nice postpaid handset growth despite the fact you've pulled back on advertising and promotions. And do you think that you can maintain this level of growth with this low level of spending. And are you starting to see any growth from the first responder community? Thanks.

Randall Stephenson

So, John, this is Randall, I'll start and John Stephens can interrupt or append as we go through this. But look we told everybody back in November that we were going to be laser focused on driving down debt and driving cash flow and we pulled all the levers you would expect.

And if you start with the TV business, we had come over the last couple of years getting the DIRECTV NOW the streaming product into the marketplace and we had multiple offers out in the marketplace. And you know, it's been a year, year and a half of learning what the market demand was going to be and what the market engaged, and the customer engagement with the product was going to be.

And as we matured the product and as we came out of mid-year you know, we just looked at the customer segment. There was a customer segment at the low end, very promotional pricing who are not engaging on the product. We didn't - we don't yet have the Xandr platform stood up to really monetize meaningfully on the digital side, the streaming side and advertising revenue. And we said until we get all those pieces in place let's pull that promotional aspect out.

And so we told you in November there were 500,000 of those customers on the promotional pricing. And we started allowing those customers to a trade out that obviously has a significant impact on dilution. You know, the product has been dilutive in 2018.

This is one of the main drivers of the dilution and this is also one of the primary triggers as we move into 2019 to getting us to EBITDA stability, as we begin to get the promotional subscribers out and now we have a customer base that's left on the streaming that's growing, remaining customer base is growing and is a highly engaged customer base and has good churn characteristics.

And so we actually like where we are in terms of how we're positioning the streaming product. And as I said, it's a major driver to how we get to EBITDA stability next year.

On the traditional linear side, these trends are in line with what you should expect as we go forward. We're not going to be horridly promotional to try to drive growth in this except where we have a good strong broadband footprint, particularly a fiber footprint and where we bundle this product with fiber we have really good characteristics, we have good churn characteristics. The lifetime value of that customer segment is really, really high. We tend to over index on wireless penetration where we have the TV product with our fiber and our broadband product. So you know we're going to continue down the path that you saw in the fourth quarter.

Now the fiber product, we will finish the lion’s share of the build by mid-year. We'll be at 14 million locations passed with our fiber footprint. You're seeing now the impact as we move our customers into the fiber footprint. You're not seeing the overall broadband subscribers grow, but as people migrate to fiber you're seeing a significant lift in ARPU. And literally we had 6% broadband growth in the fourth quarter with no overall subscriber growth. We added what John 250,000 fiber customers roughly?

John Stephens

Yes.

Randall Stephenson

In the quarter, we think those trends can continue. In fact, we think those trends are very achievable. And so this is one of those areas as we deploy fiber. We've been doing this long enough now.

The penetrations that you achieve are - there a little bit mechanical, you know very, very much what to expect, what penetration rates to expect, what periods of time and what ARPU lifts to get. So this is another one of the key elements on how you get the Entertainment Group to stable EBITDA, you continue growing this fiber revenue stream and moving ARPUs up as people move to fiber.

And then on the wireless side, yeah, we feel that we can sustain wireless where we are without having to step up significantly on promotional costs or advertising. But this is the approach we've taken to wireless, particularly in the situation we are or moving aggressively to drive cash flow and pay down debt is we will surge promotions as necessary in the marketplace and that's what we did in the fourth quarter and then we will make sure we keep our high quality customer base in check and we will do what we need to, to keep the customer base in check.

But I like how the team is executing here. They've really rationalized their targeted marketing. They're doing a really good job in terms of focusing on the customer bases we want to retain. I love what happens - what's happening in the prepaid based on cricket. Cricket continues to have really strong momentum. We did I think 240,000 cricket subscriber adds in the quarter.

What we saw offsetting that is our AT&T branded prepaid which we sell in our AT&T stores, we saw some loss there and it appears that we may be losing some of that prepaid customer base to other companies postpaid customers.

And so we're seeing a little bit of migration, so we'll play with that and ensure that up. But that's one of those where the market got incredibly promotional on the prepaid side during 4Q. And we remain disciplined in terms of the amount of promotion we put into handset costs, gave our customers a good value proposition and cricket volumes I think showed it. Do you had anything…

John Stephens

So DTV, I think one thing to point out, I mean, we had the two year price lock, we came off that starting in April. We migrated a bunch of that - a bunch those customers up to market based pricing which has caused some churn and that's what you're seeing in the quarter. We got about 2 million of those customers left. It's really important that we get those up to market pricing. But as we do that, that'll cause some churn, some pressure on net additions. So that's why we're expecting what we're expecting with regard to getting through that. But once again that's a key piece to the profitability.

Specifically on the on the AT&T prepaid that we announced, well let me just give you one example, we have a phone that was being offered by our competitors for a $100 that we know the cost was 250, so 150 subsidy just on the equipment for a prepaid customer, we decided not to do that. We knew it. We were aware of it. That caused the pressure and that was one of the reasons but a good example [indiscernible] some of the pressure in the AT&T prepaid.

By the same token, our cricket brand continues to do really well both on churn you know, and we're growing revenues in the prepaid space in total, so we feel really good about that. And your FirstNet question, the build-out's going great, we're at 40% at the end of last year, at the end of '18, well ahead of schedule. We're seeing great quality for all our customers, as well as our new first responder customers.

We're seeing the effects of 5G evolution be real and in customers hands today which is making a difference. We do have about 450,000 FirstNet qualified customers from about 5000 organizations or departments that have signed up for it. A significant amount of those early adopters were migrations, so maybe close to two thirds or 60% or so, but we are now getting a lot of new ads. And as this build out gets passed the existing 40% in the 50%, 60% and 70% so to speak as we continue make that progress, I think you'll see us begin to grow that new customer share and numbers significantly.

So we really do view that as a tailwind for the whole business as it improves existing customers quality, speed, throughput, but it also gives us visibility which we've been successful at, our teams had a good job with gaining new customers.

Randall Stephenson

We did an interesting experiment or demonstration is probably the right word on New Year's Eve at Times Square with our FirstNet network. We invited the first responder community to come to Times Square middle of the night when the crowds were massive at Times Square and used the First responder network and see what kind of speeds they would get on a fully loaded network. And I will tell you the first responder community that saw it was quite impressed and we have some high expectations on where FirstNet goes this year and next year.

John Hodulik

Okay. Thanks, guys.

Randall Stephenson

We will take the next question, thanks.

Operator

That's the line of Simon Flannery with Morgan Stanley. Please go ahead.

Simon Flannery

All right. Thanks very much. Good morning. Just continuing on FirstNet, where does the build go throughout ‘19 and ’20, when do you think you're pretty much done with that and related to that build out I think you said at CES that you plan to have standards-based nationwide mobile 5G in 2020. Can you just talk a little bit more about those plans and that put you in a pretty strong position then, how should we expect your ability to monetize that? Thank you.

John Stephens

Okay. So we have standards-based mobile 5G today with regard to 12 markets at the end of the year and I think by the end of the first quarter or early here the year will start to get better [ph] I think ‘19 is what we've announced, Mike, make sure I'm correct on that.

So we're working that, we're that first with that mobile-standards 5G. If you will it works hand in glove with the FirstNet build. So as we said before as we go to a site now and put the antenna up, put the radios up, retune it for the 700 we're also doing the physical work necessary to make it ready for 5G and from a software upgrade perspective.

And so you're connecting the FirstNet with the 5G and stay on the 5G Evolution is really spot on, Simon. As I said we're at 40% at the end of the year. I would suggest you we’ll continue at a comparable pace that we were last year. For most of this year, I won't suggest you, I won't give you a specific number. I will tell you there will be some - they did a phenomenal job at over performing last year. So I'm not going to hold them up to those standards, but we are clearly on track to get this thing done well before the five year and to get the fast - you know, get the majority of the country covered by 2020 when that mobile standards based mobile 5G network is available.

With regard to that too, we're selling that service providing that service today with regard to a hotspot or a PoC. We expect the phone to be available - couple of phones available this year. And one of those phones to be worked both backwards and forwards with regard to the standard LTE existing low band, low band, as well as the millimeter wave. So yes, we do believe that provides us a significant advantage.

The importance for me though is, is that as this FirstNet build goes, this spectrum goes up as carrier aggregation to 256 QAM and all the other technological improvements go into place our existing customer base is going to get a better sense all that in their service, we think that'll be great for attracting customers, allowing us to compete on a rational basis, as well as key to retaining customers.

So I hope I answered your question there, but it is a evolution, it is real, it affects our customers as we roll it out just about our service and it does give us that lead for 2020 as phones come out to make this widely available in the coming year.

Simon Flannery

So are you dedicating a portion of your WCS or AWS to the standards-based 5G. How that's - how is that going to work?

John Stephens

I'll let the technology guys get that in depth, but I wouldn't say that we're going to dedicate it. I'd say that we're going to make it available, but I will leave my network technology guys to make sure I don't mislead in that answer.

Simon Flannery

Great. Thanks, John.

John Stephens

Thank you, Simon.

Michael Viola

We take the next question please?

Operator

And that's the line of Brett Feldman with Goldman Sachs. Please go ahead.

Brett Feldman

Thanks for taking the question. You know, you noted earlier the success that you have when you're able to sell a video product and a broadband product in the same footprint. You're doing a great job with fiber but even when you're done with the fiber bill that's only going to be a little over 10% of homes in the country that you can serve with fiber.

But you are building a nationwide 5G network and we've seen at least one of your competitors already leverage their early phase of 5G to launch a residential 5G product. I was hoping you could give us some updated thoughts around whether you think that's a large addressable opportunity for AT&T to be a residential fixed wireless 5G provider. And do you think you have the resources you need to do that or would you have to acquire more spectrum or more fiber or something along those lines? Thank you.

Randall Stephenson

Yeah. Hi, Brett. This Randall. I will say over time three to five year time horizon unequivocally 5G will serve as a broadband, a fixed broadband replacement product. I am very convicted that that will be the case. We are obviously on a standards-based path. We want a standards-based path that is mobile first, but just like every other product evolution and mobility this will play out the same.

You know, we back in the 90s everybody was saying wireless would never serve as a substitute for fixed line voice because there wasn't sufficient capacity. Well it is a substitute for boys. We said the same thing on broadband in terms of - with the wireless device serve as a broadband replacement broadly in the iPhone and LTE really began to make that a reality and then as we look at 5G will you have enough capacity to have a good broadband product that serves as a streaming service for all of your DIRECTV NOW, your Netflix, et cetera? I absolutely am convinced that we will have that capacity, particularly as we turn up millimeter wave spectrum. That's where the capacity and the performance comes from and that's where you'll begin to see a broad - a true replacement opportunity for fixed line broadband. So I have little doubt that in the three to five year time horizon you'll start to see substitution of wireless for fixed line broadband.

John Stephens

Brett, the only thing I’ll ad is you know, right now we have as we mentioned 10 million Cricket customers, the total cost of 15 million prepaid customers. And quite frankly I think many of them may be using their phone and our broadband connections or mobile broadband connections for their service today.

So I say that is that - no that's not exactly on point with your question, but it's a reality today. It's a matter of how this migrates and it goes back to why all the spectrum we're putting up is increasing our spectral capacity by 50% to FirstNet efforts by building it with an expectation to software load 5G on it.

All of that is so important because we'll be the ones best positioned to take advantage of those opportunities as they play out, which we think will be you know over the next few years, as Randall said, three to five year timeframe.

Randall Stephenson

Ironically one of the top use cases, early use cases for 5G are businesses wanting to deploy 5G as effectively their land environment. And so think about a wireless plug and play environment. So that is truly a wireless replacing fixed line as a - is a high speed internet solution. So yeah, this will play itself out that way Brett.

Brett Feldman

Thanks.

Michael Viola

Thanks, Brett. Lea, next question please?

Operator

That's the line of Philip Cusick with JPMorgan. Please go ahead.

Philip Cusick

Hi, guys. Thanks. First following up on video, Randall can you confirm that the regular price DIRECTV NOW base is growing? And are those positive EBITDA at this point?

And then second, as you think about advertising this year, can you help us think about how you expect that, should we – given your advertising x efforts, can we expect this to grow substantially faster than the industry overall?

Randall Stephenson

Yeah. So on the DIRECTV NOW video, if you pulled a promotional customers or customer losses out the other customer base grew and…

John Stephens

And Phil, the simplest way to think about that is you take 500,000 out of our numbers and you know which is they're all gone or they stepped up to the full service, full price plan. So yes, you know our full price customers grew.

Randall Stephenson

And the ARPU, you heard John say, ARPU in the quarter sequentially is up $10, over $10 per line. And so I don't know that I can represent we're EBITDA positive yet…

John Stephens

But we haven't disclosed any of that information, but those - but we are up $11 sequentially, $10 year-over-year, but we're up sequentially in ARPU.

Randall Stephenson

And on advertising, Xandr, do I expect we will outperform the market? Absolutely. I would be sorely disappointed if we did not outperform the market. If you look at fourth quarter a streaming TV advertising business grew 26%. I mean, it is radically outperforming the market now.

And so I have little concern that we won't be able to outgrow the market. That's one of Brian Lesser's key objectives is to make sure that we're building an advertising business for video that will grow faster than the market. And we're gaining more and more conviction around this the further we get into it.

John Stephens

I'd say those are really important, but the ability to take the advertising data from Xandr and the information that data insights and provide it to Turner and allow that to be used as a kind of a merger, kind of a synergistic way to improve that advertising over there to give the turn a team that opportunity to have that information to better sell theirs is just as exciting for me as the advertising insights are for DTV NOW.

Philip Cusick

We've talked in the past about the advertising inflection point really not coming until 2020 when all the pieces were in place. Randall do you think that that's happening more quickly or is this still a year of development?

Randall Stephenson

It's a year of development Phil, you'll see a strong friend on Xandr advertising. We'll continue to grow well beyond industry levels, but when we get to the – the really big opportunity which is what John Stephens has articulated here and that is beginning to leverage our customer insights into the Turner ad inventory, that's going to be more 2020 where you start to see those results really play out.

And also as more and more people want to participate in the marketplace, the more success we have, the more we're seeing people come to us and want to bring their inventory to bear in the marketplace and use the customer insights as well.

John Stephens

And so the 2020 year for me too is a very optimistic year because there will be another political year and those political years are good for our advertising business too. So just to stay that, so yeah, getting all this done and getting it all ready for that timeframe and having it up and running could be very beneficial for us.

Philip Cusick

Got it.

Michael Viola

Okay. Thanks, Phil. Ready for the next question, Lea.

Operator

That's the line of David Barden with Bank of America. Please go ahead.

David Barden

Hey, guys. Thanks for taking the questions, appreciate it. I think I want to ask the analog to John's question on subs which is on ARPU, could we kind of talk a little bit about on the wireless ARPU what were the drivers of the sequential step down. I think we heard from Verizon that storm credits were an issue, also potentially FirstNet migrations might have been a contributor. I just wanted to kind of see where we think that's going to go in '19.

And then second on the linear video ARPU, up $7 sequentially, that's typical to see it up with the SUNDAY TICKET. But we know that there's a promotional price component to that. So if you could kind of disaggregate those two forces so we can kind of guesstimate where we could see the ARPU kind of land in 2019?

And then the last one if I could, on the broadband ARPU, it's up 6% year-over-year, but sequentially not growing. And I was trying to understand kind of which of those is the more informative, the sequential trend or the year-over-year trend in growth? Thank you so much.

John Stephens

So let me let me let me start with the DTV. You're right one, there is an impact on the SUNDAY TICKET. Two, there is an impact from discounts, but three, there's an impact from the fact that we've been doing this to your pricing initiative since the second quarter, late second quarter such that that is going into effect. So all three of those things are going in, as well as when you become less promotional, generally speaking the promotions are revenue based.

So David, what I am really saying is we have four different moving parts, but in essence we feel very good about where that process is going. It is causing some challenges on customer accounts on both DIRECTV and DIRECTV Now, but we're comfortable with where that's going and it's necessary part of that EBITDA stabilization process.

With regard to mobility on the postpaid ARPU side, I would suggest to you that the changes are - if you will from a prior year basis are pretty significant, very good. I feel good about that. And we've seen what the market reaction it seems to be accepting that, that has to do with buying up into bigger plans and the premium to get AT&T Watch, but also some of our cost structures past this have gone on.

With regard to the sequential piece of that, there is some impacts from prior years and credit and so forth. I view those is not significant change, I think on a year-over-year basis our postpaid ARPU is up probably a buck and a half. And I think there's about a $0.10 difference sequentially. So I feel good about where we're going as we continue to add customers.

So I'm not as concerned - I don't think of that as an inflection point at all, I think of it as a continued very good performance on a year-over-year basis and a good stepping off point.

I'm not sure if I if I've missed anything. Okay, we'll see on the broadband base, we'll continue. The key is to first get them on the fiber products because there's lower churn, higher retention. Secondly, you get them higher-speed, so they buy up. When you get to 6% year-over-year increase and you get to the point where you start to lap that, which we will do in the second half of next – of 2019, I wouldn't expect to have those same times of ARPU growth. It just doesn't work that way, but we are seeing improvement in that and you see it in the total revenue piece which is where we're really focused on.

We had mentioned earlier, we're continuing to see, you know, after 18 months we're getting over a third close to 40% penetration in those build base and after three years we're getting over 50% penetration in that fiber build space. So we've got a lot of opportunity left.

I think we mentioned we only have a - we have over 3 million customers, but we've built into a 11 million. So there's a lot of growth left, not only converting, but also growing total customer. So feel good about all those. I'm hopefully I'm answering your question as directly as…

Randall Stephenson

The other element that kind of factors into John's commentary on broadband, we expect good growth on broadband next year. But part of it is the legacy low speed broadband base is pretty much traded down to very low number, so a lot of that attrition ought to fall off next year as well. So we think broadband setup for another pretty good year next year.

David Barden

Great. Thank you, guys.

Michael Viola

Thanks, David. Our next question please?

Operator

The line of Michael Rollins with Citi. Please go ahead.

Michael Rollins

Hi, thanks. Two if I could. First, when you target bending the cost curve for video content in the DIRECTV business is the growth to just slow the growth of programming costs or are you targeting actual drop in total programming costs over the next few years and maybe within that context how do you look at exclusive agreements like the one that you have with the NFL SUNDAY TICKET?

And then just backing up to a higher level, when you look at that target of $26 billion of free cash flow for 2019 as you've exited, 2018 are there any changes in the contributors with respect to operations, financing costs, taxes or even what you may contribute to benefit plans? Thanks.

Randall Stephenson

So I'll start with the content cost piece Michael, and then I'll let John talk to you about the cash flow composition and decompose that for you little bit. But the answer to your question on the content cost curve is the objective as content deals come up is to move the needle and it's not on size fits all. There are some pieces of content that we look at the value of the content to the customer versus the price we pay and we say that content has to come down in terms of cost.

There's some you know where the customer engagement is high and so you know it might be hard to take the content cost down, but the objective is to keep the equation in balance. And you cannot have a business model where subscribers are declining and you continue to increase costs by 7% and 8%.

And so far the content deals that we've been through, we've had some very good success to getting rationalization for those content costs.

And so this is a not inconsequential part of the equation to getting to EBITDA stable as well in 2019. And so far early indications are we think this is an equation we can balance and it should be a healthy contributor to it.

What we have to do is the customer is just not willing to pay more for the content as the content costs have been increasing over the last few years. And so we got to get the content cost growth in line with what the customer is willing to pay and the customer is willing to pay virtually no additional money right now. So the content costs have to reflect that. So we'll be very assertive as we go through the course of this year and try to control the spend on content cost.

And then there's another element to it. And John Donovan and his team are being very smart about this and particularly on the over the top pieces. But what content has to be included in packages, you know, you can control your margins and your content costs by getting the packages more right size to the customers. And so can you bring content costs down to keep margins in check by rightsizing the packages for the customer. So there's a lot of really smart analytical work being done there to how can we help our customers by getting the packages right sized as well. John, you won't talk about cash flow.

John Stephens

So thinking about cash flow, Mike, let me try it this way. If you start off with 2018 as kind of a base, a couple of things, one, we won't have the merger deal related costs. Those will go away because we’ve got the deal done. Secondly, we'll have a full year of Time Warner, so add that back in. And Time Warner for six months this year was about $2 billion of free cash flow and the deal cost in total and all the interest everything else was about $2 billion for the first half of the year.

Secondly, you'll have - or next, you'll have - we'll begin to see some merger integration synergy benefits. We'll have some costs to putting those into place. So I don't want to overplay that, but it will be the path generator. That's kind of the midpoint from the deal.

On interest expense and total of course, we'll see some interest expense from the field costs for the full year. I take that into account when I talk about WarnerMedia generation. What you'll see though from us is a pay down of debt, reducing interest expense, offset by some of the spectrum that we've been capitalizing interest on is now being put into service very quickly by our FirstNet network team. And so as we put that in the service we'll have more that go to expense, so those two will act to offset each other in some way.

We expect to have some higher cash taxes this year. As you know this past year because of tax reform and the impacts that were retroactive, we had very low if any tax payments this year, and so we'll see that go up. And then quite frankly as we were this year and as we were last year, the benefit plan funding is - we've got no requirements for any benefit plan funding, pension or otherwise, we're very healthy in those, I think you can see that on our balance sheet. But we'll be strategic, we'll be targeted like we were at the end of this year to take advantage of our strong cash position and to provide some messaging not only to our employees about how important it is and how we're going to stand by it, but also efficiency from a tax perspective and getting some tax actions and so forth.

So hopefully I answered your question. I think you're probably focused on interest expense that’s got two items, less capitalized interest on spectrum, so a higher interest expense from that, lower interest expense as we pay down debt.

Taxes will be up from a low level this year. Full year Time Warner, no deal cost expected or something - nothing of significance and then merger integration benefits offsetting are hoping to offset merger integration project costs. I hope I’ve been as clear as I can, I think it gives you a way to build to - that makes it easy to see the $26 billion is within our achievability range.

Michael Rollins

Thanks very much.

Michael Viola

Thanks, Mike. Next question Lea?

Operator

Is the line of Amy Yong with Macquarie. Please go ahead.

Amy Yong

Thanks and good morning. I just want on Warner. It seems like a lot of us look at the streaming landscape and it looks like it's getting a lot more competitive. You have NBC launching in 2020. How are you positioning Warner and the streaming services. And is the focus going to be on sub growth or ad advertising? I guess hand-in-hand with this question, how are you thinking about your content allocation decisions. How do you balance licensing revenue to someone like Netflix versus holding it back for your own use? Thanks.

Randall Stephenson

Hi, Amy. This is Randall. We have really high expectations for our streaming service. We don't think there is going to be a proliferation of these that will succeed over time, but those who have very, very strong IP, deep libraries of IP are the ones that we think are going to succeed over time.

And so that's what we are focused on. We are strong believers and what John Stankey likes to call two sided business models, subscription commercial free elements, you know, like HBO and like Netflix. You know, there's a demand and the customers have become accustomed to advertising free subscription services. And we think HBO and a lot of the Warner Brothers content that's really premium content will fit into that mold.

But there are other elements where advertising supported models they are going to be important to keep prices down, to keep costs for the consumer down and actually fund additional content acquisition and purchasing. Xandr is a big part of making that model work. So our model will be a two sided model, with a heavy subscription service, with some ad supported elements to it as well.

In terms of the decision making on what to do with premium content is, as content deals come up, there's not going to be a cookie cutter approach to this Amy. I don't think all content is equal in that decision making process. You saw the some of the elements of Friends when the Friends rights came up from Netflix late last year, there was a situation where you ask yourself a question, how important is it to have that content on an exclusive basis versus allowing others to license and using it?

And the decision on that is one that Kevin Tsujihara and John Stankey do a lot of analytics and thinking about. But that was one we said exclusivity is probably not that critical on that type of content, but it's critical to have on our platform. So we did license it to Netflix as you saw, but on a non-exclusive basis. And so each of these decisions on significant content like that are going to be evaluated in terms of how critical is it to our platform to have it as exclusive versus you know the economics of licensing it to others.

So more to come, but we actually do believe that having a 100 or call it a 90 year inventory of incredible IP is a really important thing and when you look out at the landscape in terms of what is being consumed on a lot of the other aggregators on streaming products, you would be surprised how much of that is Warner Brothers intellectual property. And so we're going to be making some decisions over the coming two, three years on which of that property be brought in and which to be sold on a not-exclusive basis.

Amy Yong

Okay…

Michael Viola

Okay. Thanks for your question Amy. We will take one last question.

Operator

Very good. It’s a line of Walter Piecyk from BTIG. Please go ahead.

Walter Piecyk

Great. Thank you. You guys are putting in a lot of spectrum in the network which obviously is an improved performance. Last couple quarters your churn is been up a little bit, Verizon, obviously had decent gross ads. When do you think the impact of that additional spectrum will show up in some subscriber growth either in terms of gross adds or maybe lower churn?

Randall Stephenson

I think Walter you're going to see that as we get into second and third quarter this year, as the broad base of our customers begin to experience and realize the effects of the spectrum being put in. And it's really going to be scaling as we get into second and third quarter of this year and it is going to be a discernible difference from a customer experience standpoint as we turn it up and it's going to be a discernible difference for the customer without the customer having to change handsets. The lion share of our customers will just experienced this as we turn it up.

And so as John Randall Stephenson just pointed out, we're deploying FirstNet across the country, as we deploy FirstNet we turn all this spectrum up so that FirstNet becomes a driver for our overall customer base experiencing this benefit.

And so we have a lot of conviction that this is going to be a step change improvement. Our customers will experience it and it's going to be a significant help in terms of driving churn down. Add to that, as the FirstNet deployment happens, as we're getting this kind of performance, we have some fairly strong expectations on customer adds from FirstNet.

So the gross ad engine if you will, the customer ad engine we think FirstNet is going to be a significant driver of customer additions as we move into second third and fourth quarter of this year. So we have some high expectations of what we're doing on the network that this is - this is important, it's unique, it's differentiated and it's going to drive serious customer impacts as we get into the year.

Walter Piecyk

Thanks for that color on timing. Also just a second question, I want to go back to the Investor Day, on the Entertainment Group, you had that nice slide that showed you - showed how you're going to stabilize EBITDA 10 billion, one of the things at the bottom with the video services going to maintain a $25 million from the start of ‘18 to the end of - the end of ’19, or excuse me end of ‘18 to the end of ‘19. Is that really necessary to hit your $10 billion target and because giving kind of a sub losses this quarter and kind of what you're talking about as far as the impact of promotions it seems like that might be challenging to hit. So is it really necessary to hit $25 million subs in order to generate $10 billion of EBITDA on the Entertainment Group?

Randall Stephenson

Yes. If I could bring some clarity to that Walter and that is a big part of that $25 million was WatchTV, which is our very low-end content offering for our mobile subscribers and that's a very low ARPU product, but it's a profitable product and it's one that we expect there will be a lot of those added during the course of the year.

There are 500,000 of those accounts established right now. We're not yet calling them subscribers till we see behaviorally how they engage with the product and what kind of profitability we have. But that is a significant part of the $25 million. We do expect some continued obviously losses on the linear video. We talked about that. And we will achieve EBITDA stability even with the continued attrition of our traditional linear video subscribers. Does that help?

Walter Piecyk

It does. Thank you very much.

Randall Stephenson

Okay. Okay, so listen, I want to thank everybody for joining us today. ‘18 was a solid year. It was basically doing what we told you we were going to do at the analyst conference. And as I mentioned at the outset, I feel like we can check the box, we are doing exactly what we said. We feel very good about getting to 2019 and stabilizing enterprise Entertainment Group

EBITDA margins. We feel really good about the wireless business. It's a year of execution, delivering on cash flow and delivering on debt pay down and delivering returns of capital to our shareholders. So we thank you for joining us and look forward to speaking with you later. Thanks a lot.