Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Fourth Quarter 2017 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] Also as a reminder, today's teleconference is being recorded.

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

Michael Viola

Thank you, Tony. Good afternoon everyone and welcome to our fourth quarter conference call. As Tony said, I'm Mike Viola, Head of Investor Relations for AT&T. Joining me on the call today is Randall Stephenson, AT&T's Chairman and CEO; and John Stephens, AT&T's Chief Financial Officer.

Randall is going to provide an overall business update and cover our 2018 business initiatives and John is going to cover results along with the 2018 outlook, and then will follow with our normal Q&A.

As always, our earnings materials are available on the Investor Relations page of the AT&T website. It includes our news release, our 8-K, investor briefing, and a variety of associated schedules.

Before I begin, I need to call your attention to our Safe Harbor statement. It says that some of our comments today may be forward-looking. As such, they're going to be subject to risks, uncertainties, and results may differ materially. And additional information is available on the Investor Relations website.

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

Randall Stephenson

Okay, thanks, Mike. What we'll do is start on page four of the deck. And I just want to take a moment and reflect on 2017 because by any measure, 2017 was a remarkable year. It's remarkable for our country, for our industry where we operate, and for AT&T. And it's been a long time since we've seen so many, what I would call, major public policy achievements compressed into a single year like we saw last year. And we're calling these achievements because the combined impact from these is going to be growth. It's going to be growth in U. S. investment and jobs and in wages.

And all of this began early in 2017, as regulations across all industries were being rationalized.

In our industry specifically, the FCC returned us to a light touch regulation of the Internet. And this was the purchase that up until 2015, it allowed in the Internet to flourish in the U.S. tech sector to leave the world innovation. So, we obviously believe this is a step in the right direction, but this regulatory pendulum is going to keep swinging back-and-forth unless Congress steps forward and writes new laws to govern all Internet companies and to protect the consumer.

We believe that we need clarity. We need a long-term predictability on the rules of the Internet and on customer privacy. So, we're calling for an Internet Bill of Rights and you can expect us to take a leadership role on this as the discussion progresses.

Unquestionably, the biggest development that came out of Washington last year was around tax reform. Our public policymakers pulled the greatest lever they had available to them to stimulate capital investment, job creation, and wage growth. That lever was given U.S. companies a competitive tax system, one that levels playing field with the rest of the world.

We're in very early in the process, but you've seen it. Company after company is already announcing increased investment, hiring, wage increases, and employee bonuses, and we were first out of the gate. We announced bonuses for more than 200,000 front-line employees and a voluntary medical plan contribution for a total of $1 billion. And we also increased our 2018 capital expenditures by another $1 billion.

So, while public policy stole a lot of the spotlight, we did make a lot of progress on several strategic initiatives last year. The most important is FirstNet, winning that FirstNet bid. And this was going to prove to be the foundation for taking wireless network performance to a completely new level.

What we're doing is building a nationwide network with the latest technology. It's designed and it's hardened for America's first responders and then that will be our foundation for broad 5G deployment.

We're well underway with the build, including new sites in unserved or underserved rural parts of the country. We plan to deploy 40 megahertz of fallow spectrum that we've accumulated over the last for years along with the spectrum from FirstNet. And we'll also be deploying the millimeter wave spectrum from our FiberTower purchase and this is going to give us a quantum leap in both capacity and performance.

We move to Mexico, I'm really pleased with how the team is executing. They're doing so well. We added 3 million customers in 2017. We also made great progress leading the industry in terms of software-defined networking, 55% of our network is now virtualized. And as a result, you're seeing our networking and our IT cost structure falling significantly.

We also made progress moving our base of our high value customers into multiproduct bundles, saving them money; driving down churn, and earning more of their overall spend. And you can see the fruits of the strategy in our strong wireless performance this quarter in DIRECTV NOW's terrific first year in the market. Our fiber build continue to go strong. We know reach more than 7 million customer locations and expect to double that in the next 18 months. So, that's a look at 2017.

And what I want to do now is move forward to 2018 and talk about our priorities this year and that's on slide five. It's no surprise our top priority for 2018 is closing our deal to acquire Time Warner. We were obviously surprised when the government decided to try and block the merger because it is a classic vertical merger between two companies that don't even compete with one another.

With 50 years of legal precedent, it's the type of business combination that the government has consistently approved with appropriate conditions. Now, while we remain open to finding some reasonable solutions to address the government's concern, we do expect this case will ultimately be litigated in court. The trial date is set to begin March 19 and we remain very confident that we'll complete this merger.

We're also going to be laser-focused in 2018 on building the world's premier gigabit network. And again, FirstNet, combined with our fiber and our 5G deployment, is giving us a powerful platform to accelerate our move into a gigabit world. And I got to tell you, I love our position here. We expect to be the first U.S. company to launch mobile 5G service by the end of this year and our fixed 5G trials were also going very well.

We're learning a lot. We're gaining great insights into making this product a very strong commercial offering. And then, last week, the FCC issued an order that cleared the way for us to move forward with our acquisition of FiberTower and the vast majority of its millimeter wave spectrum licenses. It's what required for 5G. So, we get from FiberTower an average of nearly 360 megahertz of nationwide spectrum. And again, millimeter wave is critical for our 5G strategy and we'll be putting this spectrum to work later this year.

In video, we're going to launch our next-generation platform this spring. This platform will add cloud DVR capabilities, it will give us a third stream to DIRECTV NOW, and it will have a lot of further enhancements to the user interface. Now, I've been using this thing recently and I got to tell you, I think our customers are really going to like this. The experience is very good.

And so then before year end, we plan to launch in the next-gen product in a home centric configuration with a very thin hardware client. And just think about it this way, it's a very small, inexpensive streaming device plugged into your TV and then you connect it to any broadband service. There will be a voice controlled user interface with an integrated search feature and will allow you to search across any streaming video service that you subscribe to. So, it can be DIRECTV NOW, Netflix, Amazon, Hulu, or even YouTube. It also gives you a premium live video experience in your home with the flexibility and ease-of-use what you would expect out of an OTT service.

We're also ramping up our advertising and analytics business. This was being led by Brian Lesser, who joined us last quarter. I think he's one of the best minds in ad tech. We're really excited about this opportunity because advertisers have made it really clear to us that they're looking for a trusted option in premium video advertising, looking for an alternative to the current digital ad duopoly that can bring advertisers scale and deliver results that are transparent and brand safe.

Once Time Warner closes, we'll be well-positioned to be that alternative. We think the entire industry, advertisers, publishers, and consumers, are more than ready for this alternative. And with Time Warner, we believe we'll have the right data, the right content and the right talent to build an automated advertising platform that can transform premium video and TV advertising.

2018, we're also going to be focused further on Mexico. Our business there is going to continue to scale. We continue to move towards profitability. We have great momentum in the market; nearly doubling our subscriber base in the last two plus years and our LTE build in Mexico is almost complete.

And then, finally, our industry-leading cost structure is proving to be a significant competitive advantage. We obsess over delivering the lowest cost per megabyte in the world and we still have a lot of room to grow. So, that's kind of a synopsis of what we'll be focused on in 2018.

What I'm going to do now is hand it off to John to give you a report on the fourth quarter and our outlook for 2018. So, John?

John Stephens

Thanks Randall and thanks for joining us on the call. Let me begin with our financial summary, which is on slide seven. The positive impact of tax reform led to some significant changes in both our reported fourth quarter and annual results. This impacted our balance sheet and fourth quarter earnings. It also led to us making some important decisions that impacted our fourth quarter cash flows. We'll walk through these impacts as we discuss the results.

Revenues were essentially flat year-over-year as a strong quarter in wireless equipment and in our international operations mostly offset declines in legacy, wireless and video services.

Adjusted consolidated operating margins in the quarter were down year-over-year due to healthy increases in wireless sales and expenses from our Entertainment group, offsetting those solid growth in our international operations. And for the full year, operating margins were up 40 basis points.

In the fourth quarter, our adjusted EPS was $0.78, including a $0.13 positive impact from tax reform. Essentially, our ability to fully expense capital spending in the fourth quarter generated most of this benefit.

Remember, tax reform expensing provisions were effective retroactively to September 27th, 2017. We also made a number of other decisions with regard to with tax reform in mind including the $200 million in bonus payments to our frontline employees, an $800 million funding of our employee and retiree medical trust, nearly $100 million funding of our AT&T charitable foundation, and a number of other steps.

Adjustments for the fourth quarter include these special items; a $20 billion gain from our preliminary estimate of net deferred tax liability reductions generated by the new tax law, asset write-offs in our [Indiscernible] plant as our consumer fiber footprint continues to expand and we continue to serve new customers with those fiber capabilities, and additional storm and natural disaster impacts. And in the fourth quarter, those are primarily from Puerto Rico. Other adjustments include our annual mark-to-market pension plan re-measurement and merger and integration costs amortizations and some other adjustments.

Free cash flow was up for the quarter and was $17.6 billion for the year, even with the $1 billion of benefit payments made in connection with tax reform. CapEx for the full year also came in on target at just under $22 billion.

Let's now take a look at our operations starting with mobility, where the team turned in outstanding customer growth. Those details are on slide eight. AT&T's domestic mobility operations, as you know, are divided between the Business Solutions and Customer Wireless segments. For comparison purposes, the company's providing supplemental information for its total U.S. Wireless operations and that's what I'll discuss today.

First off, we added 329,000 postpaid phone customers in the quarter, a significant increase on both the year-over-year and sequential basis. Postpaid smartphone net additions were even more at 400,000.

Altogether, we had more than 2.7 million new subscribers with gains in postpaid, prepaid, and connected devices. And looking at the full year, we added more than 2 million of our most valuable branded smarts phone subscribers to our base. One big reason for the success is reduced churn. Postpaid phone churn continues to run at record levels, dropping to 0.89% in the quarter.

Revenues were up in the quarter, thanks to strong smartphone sales. These sales also had an impact on margins. We had a year-over-year increase of 700,000 smartphone gross adds and upgrades in the quarter as our customers kept coming back and getting new phones. Our BOGO offer was also successful and helped drive this volume increase.

This growth impacted margins. But with record low postpaid phone churn, these customers will provide financial benefits years into the future. With these and many other efforts, we expect service revenues to improve throughout the coming year and turn positive for the year.

We take a disciplined approach in building our customer base. We'll continue to be keenly focused on cost management, but also look for efficient opportunities to reinvest in our customers and continue growing.

Now, let's take a look at our Entertainment Group results. Total video customers, IP broadband connections, and bundles all grew. DIRECTV NOW had a tremendous customer growth in its first year of operation. The 368,000 net adds in the fourth quarter gives us nearly 1.2 million customers in service, and we believe the best is yet to come.

As Randall mentioned, we're close to launching our second-generation platform. We're excited about the improved customer experience the platform will bring and the newer opportunities that will come along with it. This will include the cloud-based DVR, an additional video stream to the two we offer today, and a more robust video-on-demand experience.

You're also seeing us turn the corner with our Broadband business. IP broadband gains continue to be robust even as the conversion of DSL customers to IP slows the consumer DSL customer base dropped below 1 million.

We added nearly 600, 000 IP broadband customers during 2017. Broadband penetration rate in our fiber footprint, where we have marketed our fiber service more than 24 months, are nearing 50%. Last year alone, we doubled the number of IP broadband subscribers in our fiber footprint.

A big part of our subscriber success can be attributed to the integrated offers that we have. We continue to increase the number of bundled customers. The number of households, who take both video and wireless, increased by 160,000 in the quarter or about 700,000 more wireless customers who bundle with the video. That's significant because the churn rate of our DIRECTV customers who have our wireless service is nearly half that of standalone satellite subscribers.

At the same time, we continue to work through the ongoing transition of the pay-TV industry. This transition pressures revenues and margins. We will manage this transition as we have managed other transitions over the year, but expect the pressure to continue throughout 2018.

Now, let's look at Business Solutions results on slide nine. Wireless drove growth in our Business Solutions segment, but we also saw sequential improvement in our Wireline revenue trends. Wireless revenues were up 6% on the strength of smartphone sales, while service revenues were essentially flat. Wireline revenues were down 3.5% year-over-year, an improvement over previous quarters and up nearly 1% sequentially.

We now have 1.8 million business customer locations connected with fiber. That means more sales opportunities for the team. We also expect increased business activity following the passage of tax reform.

Margins felt the impact of increased smartphone sales, but Wireline margins were up significantly to 37. 8%, something like 270 basis point increase, as we continue to drive hard on cost-management initiatives.

A big part of these cost savings come from our move to a virtualized network. More than 55% of our network functions were virtualized by the end of 2017 and there's still more opportunity as we drive towards our goal of 75% of these functions virtualized by 2020.

Our International business also turned in another strong quarter. Those results are on the bottom of slide nine. We had growth across our operations. Revenues were up 16% as both DIRECTV, Latin America, and Mexico showed strong revenue and subscriber gains. EBITDA also was up significantly, thanks to strength in Latin America and improvement in Mexico.

Subscriber growth continues to be strong in Mexico. The 1.3 million net adds in the quarter pushed our full year growth to more than 3 million and our total subscriber base to more than 15 million.

And our Latin American satellite operations added 139,000 customers, thanks to the strength in their prepaid products. The business continues to be profitable and generate positive free cash flow.

Our business units turned in a great fourth quarter, but we also have done an excellent job managing our balance sheet during the quarter. Those highlights are on slide 10. We take pride in the disciplined management of our balance sheet. We see it as a competitive advantage and value generator for our shareholders. It's the foundation our company is built on and gives us the strength and flexibility we need to invest and to grow. That foundation became even stronger in 2017, thanks to tax reforms and thoughtful measures we undertook.

First, we de-risked the existing debt portfolio by extending maturities, primarily beyond 10 years as we prepare to close the Time Warner deal. And we did it cost effectively without significantly increasing our interest rates. Our weighted average maturity is now 14.5 years at a weighted average interest rate of 4.4%. And we diversified our portfolio with about a quarter of the debt denominated in foreign currency. This gives us ample near-term liquidity to meet the demands on the business and provide solid, long-term returns to our shareholders.

Second, our terrific cash flow generation enabled us to invest in growth, improve leverage ratios, and improve dividend coverage with a payout ratio of 68% in 2017. And with the passage of tax reform, we see a significant boost to our balance sheet, reducing $20 billion of liabilities and increasing shareholder equity by a like amount. This reform significantly improves our net debt to equity ratios as well as free cash flow and dividend coverage in future years.

We also are in excellent shape with our pension plan. Our pension plan assets returned over 14% for the year, and we are nearly fully funded with no significant cash contributions required for at least five years. This is the case even with a historically low discount rate.

If you apply the average five-year discount rate to our plan, it is essentially fully funded and at the average 10-year rate, it's actually overfunded. Coming from a strong position, we plan to increase our investment allocation to fixed income assets and lower our expected return on pension assets down to 7% from the current 7.75 assumption.

All these measures have a profound impact on our financial position and I would expect the rating agencies will take notice and begin updating their models. It certainly has changed our outlook on capital budgeting, improving the returns of a whole range of products.

As promised, we'll increase 2018 capital investments by $1 billion with tax reform. Even with that, we expect significant free cash flow growth in 2018 and going forward with our dividend payout ratio improving into the high 50% range this year. And we're committed to deleveraging after Time Warner closes with plans to return to historic levels by the end of 2020, if not before.

Our management team has worked hard to build and maintain a strong balance sheet. We also know the job is never done. But 2018 brings tax reform, FirstNet and a new accounting standard that will affect our financial results.

Let's talk about 2018 on slide 11. First, let's look at immediate impacts of changes in the tax law. Tax reform provides immediate benefits and its allowing the additional $1 billion in incremental investment in 2018, much of that targeted for fiber deployment.

The lower tax rate is also expected to increase operating cash flow by about $3 billion this year compared to pretax reform expectations. We're also confident that as other businesses increase investments, there will be a potential uplift in demand for our services. We can't predict exactly when, so we didn't assume a significant increase in GDP trends in our guidance, but we are optimistic that it'll come and we'll be watching this closely. We expect our 2018 effective tax rate will be in a 23% range. The full year's impact of tax reform is expected to be about $0.45 of EPS health.

FirstNet will have an impact on our 2018 financials. We plan to move quickly with the build-out and the timing of FirstNet reimbursements could impact our 2018 free cash flow.

For example, we may have FirstNet-related expenditures this year that aren't reimbursed until 2019. We planned in net FirstNet reimbursements against the capital and operating expenditures to which they relate, so there'll be no revenue impact.

We estimate that 80% of the reimbursements will offset capital expenditures with 20% offsetting operating expenses. We expect to expense sustainability payments as paid, net of any recoveries for FirstNet approved projects. We will see a $0.05 per share expense impacts from our sustainability payments and other operating expenses from our build-out in FirstNet operations.

Additionally, we will see a $0.05 a share expense impact from increased interest expense in 2018. This comes from placing our AWS and WCS spectrum in service and no longer capitalizing the carrying cost related to owning in that spectrum. And we'll see a $0.04 a share expense increased from the lower expected return on pension assets that we previously discussed. In 2018, we will see a $0.06 a share benefit from reduced depreciation expense that we generated by the copper abandonment that we recorded in the fourth quarter 2017.

And finally, the new revenue recognition accounting standard will have a positive impact on our near-term financials. Several items will be impacted, but the biggest of these are deferral pearl of commission expenses, which will increase profits in 2018; re-characterization of some service to equipment revenues for equipment that was provided with multiyear service contracts. This was expected to have an impact on Service revenues, but not a material impact on total revenues or on profitability; and a netting of universal service and other regulatory fees against the related expense. This is expected to significantly reduce both revenues and expense, but have little impact on profits.

We still have work to do on revenue recognition, but our initial estimate is $0.10 to $0.15 per share of positive EPS impact in 2018. Our results will differ from others because of our extensive Next program as well as our adoption of deferred installment accounting contemporaneous with our 2015 acquisition of DTV. Look for more detail disclosures in the near future.

The impacts of tax reform, FirstNet, copper plan abandonment, and rev rack are reflected in our 2018 outlook, and the details on our outlook are on slide 12. On a standalone basis, excluding Time Warner, we expect adjusted EPS in the $3.50 range as I said, inclusive of the items previously discussed.

We also expect organic growth in the low single-digits, driven by continued profitability improvement in Mexico, Wireless service revenues growing in the second half of the year, cost structure benefits from virtualization and automation, and those offset by continued transformation of our video, business, and legacy services.

Free cash flow growth will be strong. We're expecting about $21 billion of free cash flow for the full year, which approximates our expected adjusted net income. And we expect capital spending to approach $25 billion or about $23 billion net of expected FirstNet reimbursements. That includes the $1 billion of incremental tax reform investment. That's it in a nutshell. We ended the year with an exclamation point, thanks to customer growth, tax reform and FirstNet. And we're very excited about the year ahead.

With that, Mike, I will turn it back to you for Q&A.

Michael Viola

Thanks, John. Tony, we are ready for the questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions]

We'll take our first question from Phil Cusick with JPMorgan. Please go ahead.

Philip Cusick

John that was a big nutshell.

John Stephens

Thank you.

Philip Cusick

So, if I can one for John and one for Randall. First, John, have you talked to the rating agencies about what the appropriate long-term leverage target looks like given the lower tax rate?

And then, Randall, sort of following up on things that John said, and I know it's early, but what have you seen from customers in terms of investing in their telecom services post tax reform, probably more conversation so far than orders. But how can that impact AT&T trends going forward? Thanks.

Randall Stephenson

So, Phil thanks for that. And one clarification, Mike is here with me, I want to make sure I said this right. We expect to get to more traditional historic levels by 2022 or earlier. And I apologize if I said 2020. The correct number is 2022, which is consistent with the advice we've been giving every time we talk about the deal.

Philip Cusick

Makes a little more sense.

Randall Stephenson

Phil, we have been in discussions with the rating agencies, but we don't -- we haven't come to any conclusions. We are still in a give and take in that process and we'll continue that. I will -- so, I expect that this will impact their models. I also understand that they are also waiting for us to close the Time Warner deal and to update their models with the new Time Warner information. So, no answer yet, working on it, and we look forward to kind of continue those conversations with the rating agencies.

Philip Cusick

Thanks.

John Stephens

Yes, Phil, on the capital spending and investment that you said specifically in telecom. We track with this gross fixed investment. If you look at business, gross fixed investment anywhere in the world, our services tend to track with that.

Fourth quarter was like a number we hadn't seen in quite some time, gross fixed investment; I think it was over 6%. It was a very, very strong number. Around here, how do high-fives when we see those kind of numbers, because that's usually an indication of general spending, because when businesses spend more capital, they generally hire more people. When they hire more people, they spend more capital. And so, specifically, you'll see businesses adding people, and those people have to have computers, they have to have machinery, they have to have broadband connections, they have to have mobile services, they have to have data connectivity. And so that is a metric we watch closely.

The anecdotal evidence, and it's purely anecdotal other than the gross fixed investment, is strong. People are talking about investing more. You've seen announcement after announcement, company saying they're intending to invest more capital as a result of tax reform and so that is our expectation. I think history is a very good indicator of this and when you talk about when you see Apple talking about investing in more facilities and manufacturing in the United States, for a company like AT&T and anybody in our sector, that's a good thing.

So, we have pretty good expectations at the B2B side of our house, our enterprise business side could catch some tailwinds. We don't have that build in the guidance we've given you because it's just too early right now. But I'm very optimistic that we're going to overachieve most economic assessments of 2018. You're finally starting to some economists get out there and very bravely just talk about 2.7% growth; I think that is very low.

And if we don't have a three hand on economic growth this year, I'll be sorely disappointed and surprised.

Philip Cusick

Correct. Thanks Randall.

Randall Stephenson

Thank you.

Operator

Thank you. Our next question will come from Amir Rozwadowski with Barclays. Please go ahead.

Amir Rozwadowski

Thank you very much and good afternoon Randall, John, and Mike.

Randall Stephenson

Hi Amir.

John Stephens

Hey Amir.

Michael Viola

Hey Amir.

Amir Rozwadowski

I wanted to touch base a bit on the video industry at this point. How do you think about the status of the linear video market? It does seem as though one of your competitors seems to be taking a more selective or focused approach in terms of their subscribers. How should we think about your go-to-market strategy for that business going forward?

And then, John, you had mentioned there are some ongoing pressures through this transition. How do you think about the margin profile of that business going forward? Clearly, you folks are investing in some of these next generation products. Given that those are still subscale, but growing but in investment mode for now, how should we think about the progression of returns of that business going forward?

Randall Stephenson

Okay, Amir, I'll go first. I'll talk a bit about the video industry and how we think about it. But since the day we bought DIRECTV, we assume that traditional linear video would be in a declining mode since kind of the nature of it, OTT and the ability to consume video on mobile devices, we believe would be the trend and the way where things went, we wanted to be in the leadership position and facilitating that kind of consumption of premium video on mobile devices. And we have been in the leadership position in that.

We have made an objective to ensure that we can transition. We run these transitions all the time, right? When you have technology transitions or business model transitions whether it's fixed phone service to mobile, whether it's a private line kind of service for business to VPN, whether it's -- you can kind of go down the list of whether it's feature phones to smartphones, we run these transitions and we think we're pretty good at it.

As it relates to video, we are standing up a video product that we are convinced will give us growth in the video platform for the next few years, and that's our DIRECTV NOW. So, as traditional linear declines, DIRECTV NOW, we think can offset that and not only that, but our traditional linear video will be repurposed.

You heard me talk about our next-gen platform that is home centric, a very thin client into the home. That will actually drive cost structure of the traditional video product down so that you could preserve margins in the traditional linear video as you grow in the over-the-top applications and video services. So, we're very bullish on video.

As we look at the numbers, our consumers are consuming more value than they used to, not less. They're consuming it on different devices. They're not just consuming it in their home. They're consuming it on tablets and smartphones, and that's where we want to be. And so we're rather bullish on that, Amir.

John Stephens

Amir, with regard to legacy or the linear TV product, think about it this way. First of all, key strategy is the bundle. When we are bundling with wireless or when we're bundling with broadband, we're seeing significant improvement. We mentioned that we've got another 170,000 homes this quarter that we've got bundled with wireless and 700,000 wireless customers that were bundled with our satellite TV product. That bundling allows us to have profitability from that combined account. It also creates higher value, lifetime value for each of those customers.

When you see us bundling with fiber, what we are seeing is a churn ratio rate that's about half the standalone satellite or video product churn. So, as we expand the fiber to 14 million over the next two years, you'll see us have tremendous opportunities to bundle with video. So, that is great.

In addition, we expect to pick up whatever video losses we have and more than that with DIRECTV NOW, and Randall spoke -- just spoke about the aspects of that, that opportunities to improve the revenues profitabilities and the reach to that.

And the last thing I'll tell you is with where to our satellite product. We're going to continue to serve what you might consider non-urban or non-suburban America, rural America. We're always going to have an ability to do that on a combined basis with our great wireless service and with our satellite TV process -- products such that we can continue to provide those who lives outside the city limits, so to speak, great quality, great choice. That's how we're thinking about the business. But as we've shown over the last two and a half years, that's all based on a relentless obsession with cost management and continuing to improve the cost structure.

And while the advertising opportunities are there for DTV NOW, there clearly also there for our traditional linear TV product. So, those are all the things we're working on. Is it going to be easy? It'll be challenging. But as Randall said, we've been through this time the transition many times before, and we feel up to the task of working through it.

Amir Rozwadowski

Excellent. Thank you very much for the incremental color.

John Stephens

Sure.

Operator

Thank you. Our next question in queue will come from John Hodulik with UBS. Please go ahead.

BatyaLevi

Hi, this is Batya Levi for John. Two questions. One, just following up on the bundling strategy, can you talk about how bundling has started to improve sub-trends both on the video and voice phone side? And if we can expect that to continue into 2018?

And how will you balance that sub-growth with profitability? Do you expect wireless margins, which were kind of flattish this year, can they start to improve? And the entertainment profitability has been coming down. Can we see a stop at that? Thanks.

Randall Stephenson

Yes, so Batya, it's good to hear from you. With regard to bundling on wireless churn, I can't give you a number of basis points, a precision amount of basis points in there. What I can point to is if you look at specifically postpaid phone, which is where the majority are really value-focused bundling is done, we're getting record levels of the low churn. And we attribute at least part of that to the bundling aspect. So, what we're seeing is working. That's the first thing.

Secondly, we're also seeing what was a very high level, 700,000 increase year-over-year in smartphone gross adds and upgrades. It continue to significant level of BYOD devices. So, what we're seeing is with this bundling opportunity, customers are continuing to come back to us that have been with us for a while and your customers are coming to us. That's what resulted, not only the great subscriber gains for the quarter, but in some of that, if you will, impact on cost and margins.

But when you look at the total profitability, we're very pleased with that and when you look at the churn impacts of that for years to come, you can understand why we make that lifetime value investment. So, that's how we're seeing that.

With regard to the video products, we're seeing a similar -- once again I can't point directly as a measurement for basis points. But as I mentioned specifically with fiber, it's cut in half on the bundling. But on Wireless, we're also seeing lowered churn. So, that's been, if you will, very helpful to the overall business.

But then when you put those multiple products together and it's not only the reduction service cost with the right to building and administration and so on and so forth, but it's also with that total customers and the ability to track all their services, we do see a long-term past-due greater value creation. That's how we're thinking about that bundling strategy, not on a day-to-day basis, but when you look at these, for example, going to turn on that longer term basis. Churn at these levels is implying 100-month and more lives for these smartphones, tremendous, tremendous opportunities. So, that's what we're looking towards.

Lastly, we're going to be able to continue to cut cost. And as we continue to cut cost through virtualization and automization [ph], we're going to be able to continue to maintain.

We have been on our path for the last four quarters of setting records in Wireless service margins and we chose this quarter to reinvest in our customer base. When you got churn at those sub-90 basis point levels, it seems like the right thing to do. And with tax reform and the other things that are going on in our business, we feel very comfortable that it is the right thing to do.

John Stephens

So, what I'd add to that, Batya, that there's probably no more powerful driver of margins in our industry than low churn. So, you think about what drives low churn. There are two big drivers. Customer SAT is the number one driver of lower churn. But the second is multiproduct bundles with our customers, the more relationships they have with this on different products, the more powerful the driver of churn is. And so that's why we relentless focus on both of these. But the multiproduct services are the second biggest driver of churn improvement that we have.

BatyaLevi

Okay. Thank you.

Randall Stephenson

Thank you, Batya. We look forward to you being on future calls also.

John Stephens

Did you fire John?

Operator

Thank you. And our next question will come from David Barden with Bank of America Merrill Lynch. Please go ahead.

David Barden

Hey guys. Thanks for taking the questions.

Randall Stephenson

Hi David.

David Barden

Appreciate it. I guess I'm that guy this quarter again. So, John, just doing the math on kind of that long series of EPS adjustments kind of taking out the hurts and putting back the helps, it kind of gets to kind of low single-digit EPS growth $2.98 to $3.03 from the $2.92 of this year. And we're looking at--

John Stephens

Let me answer to this. Low single-digits, if you want to pick 1%, 2% or 3%, I'll let you do that and $0.08 of those items that I talked about. When you add them altogether, those items are total about $0.08 of net pressure. That's depreciation, the other three were $0.14 a pressure, net $0.08 of pressure that we're observing. So, just to be straightforward with that.

David Barden

Okay, good. Thanks. But on a net basis, still seems to suggest like something is still moderating from 2017. I think we saw about $1 billion of EBITDA pressure in 2017. And I was wondering if you can kind of talk about into 2018 kind of how that EBITDA versus non-EBITDA below the line stuff is getting you to that EPS number.

And then the second piece of it is just I mean last quarter, I asked us about the enterprise flattening out. You said that there was some green shoots emerging in the pricing environment. You've actually had a pretty stable enterprise Wireline business for the whole year now. And with the essentially level three merger kind of consolidating the space, is stable the new outlook or are we kind of turning a corner here? Thanks.

John Stephens

Yes, let me with the enterprise business. We did not, as I mentioned in our guidance that our basis for our guidance. We did assume a dramatic shift in the GDP. We certainly expect continued investment, as Randall mentioned. We expect that to turn into orders, we just didn't know when and so we haven't modeled that in.

With regard to the most recent activity, we did there were some management actions, the team took we saw some improvement in our trends on our legacy revenues and some continued positive growth on our strategic services. If that continues and we can continue to pressure that through the year along with some tax reform initiated demand, there's an opportunity for us to do better than what we've modeled, better than what we've given in the guidance. So, we are hopeful and we're watching and we're going to be careful with that.

With regard to the items, David, with regard to 2018 and the operational side, improvements in Mexico, continued strong performance in Latin America, we'll continue to see some pressure from legacy revenues like wireline voice and then some early challenges with wireless service as we lap the first year of unlimited and then a movement towards voice service revenue improvement in growth. Those are the things that are going on in the business.

One thing I will point out. Remember, about $0.05 of the pressure for next year is going to be an interest expense. That's a below the line item. That's from -- no longer capitalizing the interest expense regarding the spectrum we're going to put to service with the FirstNet. That was part of that $0.08 that I was talking about.

So, while we're not giving specific guidance on margins, or on EBITDA levels, I want to make sure I give you is much color as I should to your question.

David Barden

Thanks John. And just the kind of takeaway, is the EBITDA, kind of, trajectory still pretty much in the same ZIP Code or are we seeing that improve, and that's kind of helping that EPS story?

John Stephens

Yes, I'll just say it this way, you have to have good solid performance in the business to overcome those pressures and to still come in that mid-single-digits -- or excuse me, come into low single-digits EPS growth. You have to have strong performance in the business. And the biggest item that is on that EBITDA -- two big items that we talked about. One, depreciation, which we've laid out and then two is the interest expense. Those go in large margin to offset each other.

David Barden

Great. All right. Thanks John.

Randall Stephenson

David, I'm probably on the optimistic side of business spending, as you heard my answer to Phil's question. But as you just kind of look at fourth quarter up and down the business segment, it just -- wasn't just concentrated in one area, it was multinationals all the way down to small business. We're just showing signs of improvement. And so I find myself getting somewhat optimistic. The business spending is really going to accelerate as we work through 2018.

David Barden

From your mouth, Randall. Thanks.

Operator

Thank you. Our next question will come from Simon Flannery with Morgan Stanley. Please go ahead.

Simon Flannery

Great. Thanks. Good evening. Randall, you touched a little bit on 5G and you put out a couple of press releases this year. It was obviously in the news the last couple of days. Can you just talk about where you are, what you've learned from the trial so far, and what should we be looking to you and AT&T for 2018 in 5G? What are the used cases that will get you most excited?

And then, John, just coming back to the ASC 606, the $0.10 to $0.15, I think Verizon had said that by 2020, that would sort of wind down to kind of a neutral impact. Is that the same math for you? Thanks.

John Stephens

Randall let me think the ASC 606 first. Yes, over a period of years, it will balance out as the contracts lap each other. So, yes, that's the kind of thought. And as I mentioned, the other item is with us and compares us to others, we didn't adopt deferred installment accounting that coming lease in the cable industry, we adopted and that with the DIRECTV merger. So, a lot of the items along with our next accounting that we've already been using will, to some people, give an impression that our numbers are not as much as they otherwise might have expected. Randall?

Randall Stephenson

On 5G, Simon, the used case I get most excited about is the opportunity to have nearly, a nationwide broadband footprint and it could be a fixed line replacement. The capacity is there, the performance is there, there's going to be full gigabit throughput. And so I get very energized on the opportunity over the next few years to actually build out a nationwide capability for broadband for both business as well as consumer.

And so those are the ones, by the way, that from the technology is probably the easiest to scale and so forth. But as you begin to think about mobile solutions, we will be deploying mobile solutions in 2018 and it's going to be in 12 markets, that's what we've been doing. Think of this as a puck.

Because, really, the thing is going to cause 5G to go slow more than anything else, it's just availability of handsets.

We're getting the equipment manufacturing moving, we're getting the supply chains moving, we're doing the sell-side acquisition, we're doing all the build type work, but getting the handsets at scale penetrated into the market will slow things down. So, that's why we're going to be pucks in the first part of our deployment in these 12 market, so it is a mobile solution. But it's not going to be a handset. There's not going to be that many handsets available. We'll be pushing the vendors to make that happen faster. But we know how long these things take and how long it takes them to penetrate the market.

As you think about other applications, the easy ones of that we all talk about is autonomous cars. And in fact, I just don't think those used cases work without 5G technology. It's all about low latency. People say 5G and you're thinking about speed. And speed and throughput is important. But the most important element is latency and having low latency 5G is the first technological innovation that truly gets us to low latency.

And as we think about a distributing cloud environment, we think we're in a unique place to begin distributing the cloud capability into our infrastructure. Think of all the nodes, all the access points that we have in our network distributing cloud at that level, we can take latency to a lower level than we think, virtually anybody else, but it will be a competition, it will be a race and we'll see who gets there first.

But the latency is exciting. The latency is also critical for as you think about super IoT, connected devices, and connecting everything. It's going to be important for virtual reality and augmented reality applications. So, we're taking this, to your point, used case-by-used case and that is what's determining our deployment and our build plans, our used cases and it's centered around predominantly these areas that I just articulated to you.

Simon Flannery

Great. Thanks a lot.

Randall Stephenson

Thank you, Simon.

Operator

Thank you. Our next question will come from Amy Yong with Macquarie. Please go ahead.

Amy Yong

Thanks. And following up on the Entertainment Group, you exited 4Q with really solid video trends. Do you still think you can grow a video pie and maybe perhaps, outpace the traditional pay-TV environment?

And I think, previously you've updated us on the mix of DIRECTV NOW subscribers, can you give us the mix of cord cutters and where they are coming from, that will be helpful? Thank you.

Randall Stephenson

So, a couple of things. We would expect to continue grow video customers with our DIRECTV NOW outpacing our linear customer counts in the sense of net additions. So, we do expect that.

Secondly, I would suggest to you that the mix hasn't changed much. We're still getting around 50% of them from cord nevers and around 50% of cord cutters or cord shavers.

Secondly, we are getting a disproportionate amount of those customers being multiple dwelling units, millennials, and others -- specifically those two groups and we're excited about that. So, as we move through the process we'll continue.

We still haven't seen a dramatic uptick in customers that are shifting from our full value product to the DTV NOW, but we continue to watch that carefully and continue to come up with different ways to make sure we can prove that and track that. But in kind of total video customer base, we do believe we have the opportunity to continue to grow just like we did in the fourth quarter.

John Stephens

Exactly our plan, Amy. We'll grow our TV customer base is the expectation. And as we continue to mature the DIRECTV NOW platform, we think we can actually do better. The new DIRECTV NOW platform has a lot more functionality. So, once you get cloud-based DVRs and you can put a third stream, now all of a sudden, you're entering a new marketplace with those as well and getting new functionality, we think we get higher penetration. So, we're actually very bullish on DIRECTV NOW. We think convinced economics will continue to improve as we move over the next couple of years.

Amy Yong

Great. Thank you.

Operator

Thank you. Our next question that will come from Matthew Niknam with Deutsche Bank. Please go ahead.

Matthew Niknam

Hey guys thank you for taking the question. One on capital allocation, I just -- with the significant cash savings you're laying off from tax reform, are there any areas of the business you're looking to potentially accelerate investment in beyond fiber? And on the fiber topic, does this change at all how you think about that 14 million fiber homes past target beyond mid-2019? Thanks.

Randall Stephenson

Yes, I get it. Look tax reform changes everything as it relates to capital allocation, Matthew and if I understand that as well as anybody. But when you're suddenly looking at your after-tax returns improving by 20% roughly, it just changes how you think about your investment thesis. It changes the profitability equation on fiber as well as 5G and how you think about rural and how you think about FirstNet. And so it gives us the ability to consider starting to push our fiber deployments faster and further.

And it's early. It's hard to say what it will mean as you own a media and entertainment company. But how does it affect the decision-making as it relates to investment in premium content, as it relates to direct-to-consumer distribution and how fast you go in those regards.

So it's -- we've been planning for this for quite some time. But now that it's here and it's real, we're going through, we're digging in, and ask what are these projects that we want to be investing in and these initiatives we want to be investing in that could continue to drive growth over the next five or six years and let's take advantage of it.

John Stephens

Now, we are expecting more money on fiber to accelerate the process and achieve our goals and then we'll have the opportunity to look to expand.

Secondly, we are, if you will, excited about and I think the team is working very, very hard to achieve the FirstNet goals and even exceeding the goals set out by the FirstNet authority. That's a really positive thing for us. And while we were interested in doing that for some time, tax reform and the cash generate, the cash savings aspect that provide us that opportunity -- flexibility to go after that even more. So, those are two areas where I think you'll really see us utilize the benefits of the new tax laws.

Matthew Niknam

Thanks Randall, thanks John.

Randall Stephenson

You bet.

Michael Viola

Hey Tony, this is Michael; we'll take one more question.

Operator

Thank you, sir. That will come from Scott Goldman with Jefferies. Please go ahead.

Scott Goldman

Hey guys, good afternoon. And thanks for fitting me in. Maybe Randall, if you can just talk a little bit about the wireless competitive environment. Obviously, still very competitive, but it seems like we've been operating in a pretty -- in a more rational environment of late, and that's driven some better results in fourth quarter. Just wondering how you think about, overall, what you're embedding in your outlook in terms of the competition in 2018?

And maybe just a quick one follow-up with John on that same question. How do you think about the puts and takes on ARPU based on the expectations for competition in 2018? Thanks.

Randall Stephenson

My outlook for wireless competition is that it will continue to be intensely competitive and we don't see that changing. How people are competing has changed somewhat and how we're competing is changing quite a bit. I'm not going to go into a lot of details because we made some moves in the fourth quarter and you're going to see those continue into the first, second, and third quarter. We think are going to be very effective and has been very effective in the marketplace. But I'll call it smarter competitions, smarter way in approaching our customer base and in accessing new customers. We believe very strongly that combining video with our mobile product is a really important element.

And you will see us continue to do that. But actually, probably take it to new and different levels because it's proving so powerful on churn. We're also getting to place we've learned enough that is becoming very powerful as it relates to customer acquisition.

And so combining video with wireless is a really important driver and you've seen some of the industry begin to make moves to mimic that, which is usually an indication that you're having success and so you'll see more and more of that. But it'll remain competitive, but we feel really good about how we're set up, what we're doing in the marketplace and that we'll continue to even take that a step further as we move through 2018.

John Stephens

Scott, on the ARPU side, let me first make sure we're clear with regard to rev rack and the adoption of it and it's an unusual accounting change and then it's a flash cut. So, couple of the changes include regulatory fees, USF [ph] which we can't a service revenue today. And then also, in the expense line, they'll be netted. So, ARPU will come because we're pulling back out.

Secondly, there will be some of the service revenue that's called service revenue today we'll get allocated to equipment revenues in the future for that small number of situations where we still subsidize equipment.

Once you take that into account, you will have comparable ARPU and I just want to make sure everybody knows that. With regard to the opportunities for ARPU, I think about it in a total profitability situation, not just in an ARPU situation. So, we certainly are looking to do as strong as we can on ARPU and as many services.

But as Randall said at the beginning, we're relentless on this lowest cost per megabit provider. And as we get to that, we can be very successful with things like prepaid or other alternative levels of ARPU.

My only point is that though we bundle with regard to video and broadband wireless together and we get great ARPUs from those, there will be situations where we will look to accept lower ARPUs like in prepaid.

And because of the very low cost structure, because of the billing, or general administrative cost, because of opportunities to maybe get that analytics value out of it, we'll be able to still be profitable, or we'll be able to expand the base of customers and be able to make more total profit that way.

So, that's one of the reasons why we're not giving EBITDA margin guidance, is because we want to focus on this total cash, total profitability position. So, our ARPUs will continue to be measured relentlessly and we'll continue to analyze of them in the same way. I want you to understand that we're really focused of that total service revenue growth, total revenue growth, total profitability as opposed to just any one aspect.

Scott Goldman

Understood. Thanks.

Randall Stephenson

Very good. Thank you, Scott. And listen, I want to thank everybody for joining us today. 2017 was a truly unique year for American business, U.S. business. And I think 2018 is going to prove to be a really good year for the realization of the implications of what was done in 2017. And I think the consumer is going to be better off, I think wages are going to be higher as businesses invest more. And as a result, AT&T being a very U.S. centric company, we think we're going to have a good year ahead of us as well. So, again, thank you for joining us and look forward to talking to you next time.