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EDITED TRANSCRIPT

T - Q1 2019 AT&T Inc Earnings Call

EVENT DATE/TIME: APRIL 24, 2019 / 12:30PM GMT

OVERVIEW:

Co. reported 1Q19 consolidated revenues of \$44.8b and adjusted EPS of \$0.86.



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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the AT&T First Quarter 2019 Earnings Conference Call. (Operator Instructions) I would also like to remind you that this conference is being recorded.

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

Michael J. Viola - AT&T Inc. - SVP of IR

Okay. Thanks, Greg. Good morning, everyone, and welcome to the first quarter conference call. Like Greg said, I'm Mike Viola. I'm Head of the Investor Relations here at AT&T. And 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 update of the key 2019 initiatives, then John is going to cover our operating results. Then, of course, we'll follow that with a Q&A.

Before we 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 subject to risks and uncertainties. Results may differ materially, and additional information is available on the Investor Relations website.

I also need to remind you that we're in the quiet period for the FCC Spectrum Auctions, Spectrum Auctions 101/102. So we can't address any questions about that today.

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

And so now I'd like to turn the call over to Randall Stephenson.

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Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

Okay. Thanks, Mike. And we do appreciate you joining us this morning. I came to you back in January, and I outlined 6 priorities for 2019. And we have those again listed on the third slide. But if I could quickly summarize, what I would tell you is in all 6 of these areas, we're either on track or well ahead of schedule.

And the first one, as you remember, I told you that paying down the \$40 billion in debt that we took on to acquire Time Warner that, that will be our top priority. And we are on target to retire 75% of that by year-end. This quarter, we generated free cash flow of \$5.9 billion and brought our net debt down by \$2.3 billion. And that puts us well on track for generating at least \$26 billion of free cash flow for the full year.

And then already here in the second quarter, we've sold our stakes in Hulu and Hudson Yards. That generated an additional \$3.6 billion of cash. And then John Stephens' team is doing their typical great job. They're driving down working capital and restructuring some collateral arrangements, and this is also adding significant cash flow, and it's giving us very clear line of sight to reaching our target of \$6 billion to \$8 billion from asset monetizations. So bottom line, we committed to driving our net debt-to-EBITDA ratio to around 2.5x by year-end, and we are right on track for achieving that.

Second priority was mobility. And we had another really strong quarter, and it continues to grow and build momentum with customers. Our wireless service revenues increased by 2.9%. EBITDA grew. And that's even with some significant accounting pressures. Our postpaid and prepaid phones grew very nicely and churn remains low across both products. So all in all, I'd have to tell you I'm very pleased with our wireless performance.

And then stabilizing profitability of our Entertainment Group. This was a must-do for us this year. And John Donovan and his team are exceeding expectations. And not only are they stabilizing EBITDA, but they're growing it by nearly 7%. There was a small one-time item in there from a carriage dispute settlement, but even removing that, growth was a very healthy, I think, around 5% excluding that. And so that was led by 8% growth in broadband revenues. I got to tell you, our fiber product, the AT&T Fiber product, is doing very well in the marketplace.

On the cost side, the team is doing terrific work on controlling content costs, promotion costs and all the other operating costs. And then finally, some aggressive customer segmentation and targeting are driving some higher video ARPU's. And so I think what you should expect is as we work through the year, we'll continue to see declines in traditional TV subs, particularly those areas where we can't bundle with broadband. But as we get into the second half of the year, we roll out our thin client video product, it will be a much lower-priced product in the marketplace. What I think you'll see is subscriber losses should lessen as we get into 2020.

And then I think the DIRECTV NOW customer base, that's our streaming over-the-top product. That should be pretty stable for the rest of the year. We might see some slight customer losses in the second quarter as the price increases continue to flow through, but second half of the year should be decent.

Bottom line, I remain comfortable that we're either going to meet or exceed our Entertainment Group EBITDA target for the full year, and that's going to lay the groundwork for continued stability as we move beyond 2019.

At WarnerMedia, it's been a really strong start to the year. Revenue growth was solid. Operating income grew by double digits. Our merger-related synergies are on track, and we expect to hit \$700 million in run rate by the end of this year. Stankey and his team have reorganized the business to compete in a world of streaming and streaming content.

We brought in some great new talent like Bob Greenblatt. He's a known commodity. He's running WarnerMedia Entertainment and he's also leading the SVOD development project for us. And I got to tell you, I think he's one of the best around, and I couldn't be more excited to have him onboard. Bob and his team's top priority is to develop our new SVOD service. And as we've discussed, this is a service that will be centered on HBO and significantly enhanced by the Warner Bros. library, which is a very, very deep and prolific library. The closer we get to launching this service, the more excited I get. We're planning a WarnerMedia Day for everybody in the September to October time frame. And we're bringing in all the executive team across from WarnerMedia and we're going to give you a detailed look at the product, and that includes the breadth of new and existing content. So just stay tuned for that. And we're making significant investments here, and we think our customers are going to love this product.



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Now every facet of our strategy is built on a foundation of world-class connectivity. And a few years ago, we set out to build the best video delivery platform in the world, and we invested billions of dollars securing spectrum licenses. And we made it among our highest priorities to go after and to win FirstNet. That's the national network for first responders. And today, our FirstNet build has now passed the halfway mark and is running well ahead of schedule. We now have more than 7,000 agencies signed up across the country with more than 570,000 subscribers, and those numbers are growing.

This initiative, along with our vast portfolio of spectrum, has catapulted AT&T into the leadership position in network quality. Over the last few months, AT&T has been recognized as both the best as well as the fastest wireless network, and FirstNet has enabled us to accelerate our 5G and fiber build-out.

Our 5G service is now in parts of 19 cities, and we'll have 5G coverage nationwide next year. We're the only carrier to offer 5G service to businesses and consumers and we're well ahead of our competition here. And our AT&T fiber network now surpasses 20 million locations. That's both consumers and businesses. In short, our network investments are paying off, and we're not done yet.

Finally, Brian Lesser and his team continue to grow Xandr. That's our advertising business. Revenues were up 26%, including the AppNexus acquisition. They had strong EBITDA margins, and we're continuing to invest in new product development and capabilities as we integrate more of Turner's ad inventory.

So we're very pleased with the progress we're making. Our strategy is working. Our key initiatives are on track. And you can expect strong execution on these priorities as we continue in the quarters ahead.

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.

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

Thanks, Randall. And good morning, everyone. And once again, thanks for being on the call today. Let me begin with our financial summary on Slide 5.

Adjusted EPS was \$0.86 in the quarter. WarnerMedia continues to be accretive. Mobility is adding customers, and we saw EBITDA growth in our Entertainment Group. Offsetting these positive signs was about \$400 million of noncash impact from the reversal of rev rec and fulfillment deferrals. We expect those headwinds to continue throughout the year and we've included all of those in our guidance.

Adjusted earnings included higher interest expense from the Time Warner acquisition and the noncash impact of lower capitalized interest as we continue to put additional spectrum into service in our mobility business.

During the quarter, we also had a mark-to-market adjustment to our pension plan based on our expected distributions for the coming year. The \$0.05 impact reflects lower interest rate even though we significantly exceeded our returns on plan asset assumptions.

Consolidated revenues came in at \$44.8 billion, up 18%, thanks mostly to the acquisition of Time Warner. The gains in mobility service revenues, WarnerMedia and broadband were offset by a foreign exchange impact of approximately \$550 million and lower U.S. wireless equipment sales of about \$175 million as well as a little bit of ongoing legacy product pressure. When you look at a pro forma basis, revenues were down slightly due entirely to the impact of foreign exchange and lighter equipment revenues. Without those impacts, revenues were up.

Operating income showed solid growth, and adjusted consolidated operating margins were 21.4% or up 170 basis points with strong growth in WarnerMedia and mobility and significant improvement in our Entertainment Group. EG's first quarter EBITDA puts us in solid shape to meet or beat our full year EBITDA target for EG.

Our cash flows also continue to be impressive. Let's look at those on Slide 6. Both our cash from operations and free cash flow saw strong growth. Cash from operations is up 24%, mostly reflecting WarnerMedia. Free cash flow was \$5.9 billion. The addition of WarnerMedia operations obviously



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made an impact. For example, our securitization efforts got a lift of more than \$1 billion from adding WarnerMedia to our program. This helped overcome \$700 million in pressure from income taxes where, in the first quarter of last year, we received a significant refund from the December 2017 passage of tax reform.

When you look at our free cash flow for the past 12 months, we're well over \$25 billion. And with a full year of Time Warner, we have confidence in meeting or exceeding our \$26 billion range cash flow guidance.

Our dividend payout of free cash flow is about 63% in the first quarter, another healthy amount. We also continue to invest at high levels. Our reporting CapEx was \$5.2 billion, and total capital investment was right at \$6 billion when you include \$800 million of payments for vendor financing arrangements.

We have been receiving favorable payment terms from several suppliers, which allow us to be more efficient with our spending. And you see that in our capital investment in the quarter. We had about \$700 million of equipment assets put into service during the first quarter that we won't have to pay for and aren't included in our CapEx number because of these new vendor financing activity. And as a reminder, payments made under our vendor financing obligations are classified in the cash flow statement as financing activities, not investing activities.

I'll get into more detail about our leverage a little later, but our net debt declined a solid \$2.3 billion in the quarter. In addition to strong free cash flow in the quarter, we amended many of our collateral support agreements with our lenders, which allows us to reclaim most of the collateral posted for our foreign currency hedges. The net result was more than \$1 billion in cash returned to us, fully offsetting our vendor financing payments. And we don't expect to post much additional collateral during the 5 years of this arrangement.

In fact, we expect to get another \$300 million or more in collateral returned to us in the second quarter.

Let's now look at our segment operating results, starting with communications on Slide 7. Mobility turned in another solid quarter with service revenue growth, solid margins and postpaid and prepaid phone growth. Our Entertainment Group got off to a good start in stabilizing EBITDA for the year. In fact, we grew at nearly 7% in the quarter thanks to broadband revenues growing more than 8% and tight cost controls. In fact, our broadband growth exceeded our legacy revenue change in the quarter.

Communication revenues were up slightly when you exclude lower equipment revenues from the fewer smartphone upgrades, and margins are up 20 basis points even with the accounting headwinds and lower Business Wireline EBITDA. Business continues to be impacted by legacy declines and then transition to lower-margin services. The first quarter had a tough year-over-year compare, and this year, we had higher deferral amortization and a wholesale business customer default, but we still posted \$2.5 billion of EBITDA for the quarter.

Now let's take a deeper look at our mobility results on Slide 8. Solid service revenue growth drove wireless revenue gains even as equipment revenues dipped to the lowest upgrade rate in our history. Service revenues grew by nearly \$400 million or 2.9% in the quarter, and EBITDA grew by about 2% even with noncash accounting headwinds of \$200 million and subscriber gains in postpaid and prepaid phones.

We grew postpaid phone net adds by 80,000 in the quarter, a significant improvement compared to a year ago. And FirstNet continued to be a tailwind to customer growth. In prepaid, we had 85,000 phone net adds, our 17th consecutive quarter of growth. We continue to be strategic here as well, focusing on the high-value prepaid market.

Cricket is our flagship brand in prepaid. It generated strong subscriber growth and had its lowest-ever quarterly churn rate of less than 3%, down more than 60 basis points year-over-year. Prepaid revenue growth was solid, up more than 6%. We now have more than 10 million Cricket subscribers, double what we had when we acquired the company in 2014, with more than 17 million total prepaid customers under the umbrella of AT&T.

Randall already mentioned our many network achievements. But I will also point out that the percentage of new FirstNet customers is shifting to more customers new to AT&T and fewer migrations.



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Let's now look at our Entertainment Group results on Slide 9. The headline in Entertainment Group is growing EBITDA and operating contributions, and we're confident we'll meet or exceed our target of stabilizing EG EBITDA for the full year. EBITDA grew by more than \$180 million and margins expanded by 180 basis points to 24.7%, reversing a trend that we saw last year, as the chart shows.

A few things drove that improvement. First was good expense control, both with content cost moderation from some recent renewals and operational cost, such as lower advertising expense and promotional spending. Also, we had a one-time settlement of a prior year carriage dispute that helped the first quarter by about \$40 million. So even without that one-time event, we'd had growth of over 5%.

Third, our video ARPU increased as we focused on higher-value customers, reduced promotions that move our pricing to market for both premium and over-the-top service offerings. Advertising revenues also continued to grow. Our premium ARPU grew for the first time in 5 quarters, up more than 2%, and DIRECTV NOW ARPU was up more than \$10 year-over-year.

The number of premium TV customers on a 2-year price-locked promotion declined by about 700,000 in the quarter. We still have about 1.6 million customers left on that pricing, and we'll work through those for the rest of the year. Our focus is on the long-term value customers.

Secular declines and pricing moves we've made did result in fewer gross adds and 544,000 fewer video subscribers. Changes to packaging and pricing in DIRECTV NOW impacted over-the-top net adds as well, but significantly less than the fourth quarter.

Broadband revenues grew by more than 8% and contributed to EBITDA stability and growth. We've seen continued ARPU improvement in both video and broadband for the past year helping us stabilize and grow EBITDA. We expect IP broadband ARPU growth to continue, but at somewhat more moderate rates as we lap the step-up that we saw in the second quarter of last year.

We gained nearly 300,000 AT&T Fiber customers in the quarter, bringing the total in service to more than 3 million. And we now passed more than 12 million customer locations with fiber. For the quarter, we added 45,000 broadband customers.

During the quarter, we updated our billing process for premium video and broadband customers. Customers are now billed and receive service for the full month when they stay -- when they are in the last month of service, which is consistent with our content cost and mobility customer policies as well as the rest of the industry. This generated additional revenues for us and gave us additional time to win back customers. Customers in service at the end of the period were higher because of this change, about 117,000 subscribers in premium TV and 38,000 in broadband. We expect the video net add challenges we saw in the first quarter will continue.

Achieving EBITDA growth for the first quarter was a tremendous accomplishment for our Entertainment Group team. We continue to have confidence that we will meet or exceed our EBITDA target for the full year.

Let's move to WarnerMedia's first quarter results, which are on Slide 10. WarnerMedia continues to exceed our expectations and had a strong start to the year. Revenue growth was up more than 3%, and operating income once again showed double-digit growth at nearly 12% with gains in all 3 units. And WarnerMedia continues to be accretive to both earnings and free cash flow.

Warner Bros. revenue grew by nearly 9%. Theatrical revenues increased primarily due to carry-over revenue from Aquaman. Television revenues increased primarily due to higher initial telecast revenues.

HBO revenues declined, mainly related to a carriage dispute with one of our distributors, but still realized operating income growth for the quarter. HBO's operating income was up due to lower programming costs. We continue to increase investment in high-quality content. However, programming costs declined primarily due to the timing of content releases and some lower amortization expense.

Turner revenues were down slightly. Subscription revenues continue to grow thanks to higher domestic affiliate rates, but this revenue growth was offset by ad revenue declines, primarily from the every-other-year shift of the NCAA Final Four games. We aired the Final Four games in the first quarter last year and reported all that ad revenue. This year, CBS reported that. In years which CBS broadcast the Final Four games, we report



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our share as participation interest, not as ad revenue. That explains the difference, virtually all the difference in our ad revenues. With that, Turner's operating income was up 7%.

WarnerMedia is set for a solid year. The final season of Game of Thrones is underway and viewership is breaking records. More than 17 million people turned in for the season premiere, and to date, more than 27 million people have watched the episode. In fact, we added more HBO NOW subscribers in the week leading up to the season 8 premiere of Game of Thrones than in any other week in the service's history. Those numbers will show up in the second quarter customer counts.

We also had another successful airing of the March Madness. The NBA Playoffs are going full steam on TNT. Warner Bros. Shazam opened earlier this month and is doing well at both domestic and international box office. And later this year, we have our next Godzilla movie, It: Chapter Two and then Joker, to name just a few of the great movies slated to be released.

Now let's look at Xandr and Latin America results on Slide 11. Still very much in the early days for Xandr, but it continues to execute and expand. Revenues were up more than 26%, including AppNexus, our strongest first quarter growth in the last 3 years. Growth rates in this business tend to be seasonal and event-driven, such as election days, with growth ramping throughout the year. EBITDA margins continue to be strong, and we continue to invest in developing our advertising platforms.

We're making progress integrating the Xandr marketplace across all of AT&T, and Xandr is now helping optimize Turner inventory. Xandr will also be working with Viacom as a result of our recent content negotiations, so we're excited about that. We've discussed many times the potential joint benefits of blending premium content with our data and distribution to take advantage of targeted and relevant advertising opportunities. These agreements can help distributors and help content providers, and most importantly, help our customers.

Turning to Latin America. We continue to deal with foreign exchange and local economy challenges. Total Latin America revenues and EBITDA were down year-over-year primarily due to those pressures. But on a constant currency basis and excluding Venezuela, revenues would have grown 0.3% on a comparable basis.

In Mexico, we saw solid service revenue growth, which was offset by lower handset sales in the quarter. We're making good progress on our goal to achieve profitability in Mexico. While we still have plans for more improvement, EBITDA improved by \$58 million year-over-year. We are improving operating income and maintain line of sight for EBITDA to breakeven in the second half of the year.

Coming into 2019, we adjusted our subscriber base in Mexico to reflect the impact of a double count from certain third-party distributors and the sunset of 2G services. We continue to take operational steps to improve the quality of our sales and profitability. This includes focusing on higher-value customers, adjustments to dealer commission structures, reduction in the subsidies and targeted price increases. Each of these changes improves the long-term value of our business but puts pressure on volume comparisons. Even with our focus on higher-value customers, we continue to grow our subscriber base of nearly 18 million subscribers. Given our focus on quality, we expect to see continued net add growth as churn improves.

Foreign exchange significantly Vrio, but revenues were flat sequentially. If you look at the results in constant currency, revenues were up year-over-year and the business continues to be profitable and generate positive cash flow. The beginning of the year customer base was adjusted for the prior year after we identified and shut off a group of nonpaying customers. Vrio net adds were down, but our total subscriber base remained stable from a year ago.

Now before we get to your questions, let me give you an update on deleveraging. That's on Slide 12. As you know, our goal is to get to the 2.5 net debt-to-EBITDA range by the end of this year through free cash flow, asset sales and overall cash management. And we're off to a really good start.

First, our free cash flow, working capital and collateral agreement initiatives helped us reduce net debt by \$2.3 billion in the first quarter. Remember, the first quarter is usually our toughest quarter for free cash flow. We still expect our free cash flow after dividends to generate about \$12 billion this year and expect to use it to pay down the debt.



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Second, we have significant asset sales that put us well on our way to our asset monetization target. And it includes the sale of our interest in Hulu for \$1.4 billion, which closed on April 15; and the pending \$2.2 billion sale of our interest in Hudson Yards, which was just announced. This puts us in solid position to meet our leverage target for the 2.5x range by the end of the year. We're sharply focused on this. The team has done a superb job so far, and we expect that to continue through the rest of this year.

Mike, with that, we're ready to take some questions.

Michael J. Viola - AT&T Inc. - SVP of IR

Okay. Thanks, John. Greg, we'll start with the Q&A, and we'll take our first question, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of John Hodulik from UBS.

John Christopher Hodulik - UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst

Maybe a couple of questions on EG. First, maybe for John, the 5% growth -- adjusted growth on EBITDA was quite a bit better than we thought. And we were led to believe, given the price changes, that you would actually see improving trends later as the year progressed versus the first year. So would it make sense? I know you didn't really change guidance. You said there could be some upside. But how should we think of the cadence of that as some of these price increases work through the system there?

And then maybe drilling down on the traditional sub losses. I guess we get some -- we understand how NOW is going to continue to moderate given what's going on with Game of Thrones in HBO. But on the traditional side, we're using [6 61] for losses this quarter given the \$117,000 sub adjustment. First of all, is that the way to look at that?

And then, Randall, in your remarks, you said things should improve in the second half. And John, during your remarks, you said that you'd still expect to see challenges. What is the cadence of that? Should we be using the 6 61 this quarter as the base of losses going forward? And the 1.6 million still on promo, what's the cadence of those guys coming off and adding to churn? Just how should we think of that line going forward?

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

Yes. So John, let me try this. Let Randall kind of clear up what maybe I don't make clear. First, on EBITDA, it was really great growth. We did have -- we mentioned a one-time adjustment. It was about \$40 million. But the EBITDA growth was close to \$200 million, so it was only a small part of it. So it was really good, that growth, and we're pleased and have confidence that we're going to meet our goal of stability. We're not raising our guidance. But as Randall said, and I repeat it, it's clear that we're on line of sight to not only meet but exceed that target. So we're just being careful with our representations going out.

We'll continue to balance things and continue to measure cost and go after high-value customers. So we're leaving ourselves that flexibility. But we are clearly on track. I wouldn't suggest to you that you can draw a straight line out, but I feel really good about where we are on EBITDA growth. So that's my best attempt to make a direct answer. We feel very good about it. We continue to expect to meet our guidance. At this stage, I understand why you would think we're going to exceed it. We'll let that happen and we're going to stick with our guidance as it is today with the understanding that we're outperforming on many respects.



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With regard to the sub losses, I think of it as -- the [5 44] is the right number. I understand we pointed out the change in the billion. But remember, that's just an item that continually gets refreshed and is always out there. So it's not a loss each quarter or an adjustment each quarter. In the second quarter, it just refreshes itself. So it's just kind of just a timing item on a one-time basis.

Secondly, we did price increases on an annual basis in January. So that affected -- all the customers got some price increase. That affected the linear. And we had about 700,000 customers impacted by the 2-year price lock. As we go through the year, we won't have another annual price increase per se. So that will have -- that impact on customer accounts won't necessarily be there in that light. And then secondly, as we get through now down to about 1.6 million -- at the beginning of the year, 2.4 million on price locks. As we get through the rest of those, we'll see less and less impact from those just because we get through the process. We expect that process to continue through November, which is the 2-year anniversary of the last time we had an offer on this. But we'll see a lot of that activity going through in the second quarter. That's the difference between the first quarter and the rest of the year in the sense of the annual price increase as well as the largest group of the 700,000 customers hitting by the 2-year price lock.

Randall, what would you add?

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

Yes. On the subscriber losses, I said particularly on DIRECTV NOW, our streaming product, that we've put the price increases in. And we've seen the effect of that in the fourth quarter and the first quarter. Second quarter, you'll see that moderate. And I actually believe second half of the year, based on what we're seeing in terms of uptake in the market on the new platform and the new product, that we should have a decent second half of the year on DIRECTV NOW.

On the traditional premium product, DIRECTV, I said you should expect -- continue to see losses as we move through this year, but we'll be launching second half of the year the thin client, which think of that as our satellite replacement product. And why this is so important, it allows us to get into the market at a lower price point. When you look at the DIRECTV churn, it's interesting. What you see is not people at the high end in terms of ARPU's that are churning. It's disproportionately at the low end and where we don't have broadband. And so this thin client gives us an opportunity to meet that low end with a better price point, and this should start to moderate the subscriber losses. And particularly as we get into 2020, we think this product is going to have a really good appeal for people down market in terms of their expectations of video pricing.

Operator

Your next question comes from the line of David Barden from Bank of America.

David William Barden - BofA Merrill Lynch, Research Division - MD

I guess, first, I guess a kind of a bigger picture question with respect to the DTC strategy, Randall or John Stankey, if he's on. A couple of weeks ago, we saw Disney launch a DTC product or announce a launch with lower-than-expected pricing, bigger-than-expected losses. Numbers came down and the stock jumped 10% because people were looking at this as kind of a standalone Netflix being incubated inside Disney. And I was wondering if you guys could kind of address how you guys think about how the market would react to a similar announcement at AT&T and if you could, at this stage, kind of dissect a little bit about what you think is good and strong about the Disney platform announcement and what's maybe vulnerable about their approach and the opportunities you see for yourself to come into that market. I guess kind of on a related topic, could you talk a little bit about what, if anything, the Hulu sale might mean to the financials of the business? My guess is that you'll kind of see less losses from that flowing through to the earnings statement. And if you could kind of size that, that will be helpful for us.

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

Sure, David. This is Randall. On Hulu, fewer losses and less capital requirements.



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John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

No cap, no calls.

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

So -- but we received \$1.4 billion in cash. And we're no longer in it, and so the capital calls go away, obviously. So on the Disney launch, I was impressed by what Disney did. I was -- also, I thought the market reaction was an indication that people look at what Disney would be able to bring to market in terms of original content, library of content, deep, strong brand content and new and original content and talking about the licensing that they'd be pulling back in. And I think what it did is gave the market an appreciation that this is a viable direct-to-consumer product that will have good appeal for a broad number of customers, not just in the U.S. but around the world. And so I thought it was very instructive from that standpoint.

From our standpoint, you'll be able to formulate your own opinion in September or October about what we'll be bringing to bear. But in terms of premium content, think about the HBO brand. In terms of breadth of content, consider the Warner Bros. library and the depth of that library, the new original content creation machine at Warner Bros, which is really an impressive scale machine in terms of producing theatrical as well as TV productions. And we're actually quite optimistic that we have something from both a magnitude of content, breadth of content, depth of content, new and original generation and creation capabilities that we believe we can bring to market and will have significant customer uptake. And we'll lay out for you those details in terms of what we think that looks like, what our expectations are for this product, including pricing and so forth. We're not ready to fully disclose all that yet. There's a lot of work being done. Bob Greenblatt is just getting his hands into this and working it aggressively. But I would tell you we're very, very optimistic, and the Disney announcement gave us nothing but more optimism in terms of what we think we'll be able to bring to market.

Operator

You next question comes from the line of Simon Flannery from Morgan Stanley.

Simon William Flannery - Morgan Stanley, Research Division - MD

I wonder if we could turn to wireless. Perhaps you could just update us on the outlook on the wireless service revenues for the rest of the year. Another good performance and the adds turning around despite churn continuing to be a little bit higher year-over-year. So talk us through the network improvements and how you're going to market to take advantage of that and how that should shape during the year.

And any updated color on the 5G rollout? We haven't really seen a lot on the commercial side. So when do we see more kind of opportunities in terms of pricing, plans and so forth? Is that when the sub-6 gigahertz chipsets come out?

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

Sure, Simon. Let me take a run at it and ask Randall to back me up on it. First of all, the wireless revenue outlook continue to be positive. I stand by our guidance and expect new service revenues. We had a great growth, almost 3%, 2.9% in the first quarter. I will point out that last second quarter is where we saw some service revenue growth, so our compares get a little tougher in the second quarter and then a little bit more tough in the third quarter next year because of the growth we had last year. But that's all right. We'll still expect to grow it. It just has little tougher compares. That's one. Two, why do we expect the growth? Because we do expect customer net adds. This first quarter was a first time in, I think, 5 years we had positive postpaid phone growth. We had solid prepaid phone growth. I think probably close to 170,000 or so voice net adds in the first quarter. In total, it's really a great number for us and a game changer. It shows the impact we're having in the marketplace. So we feel good about the momentum coming out of that and that opportunity going forward. I'll give you a sidebar. Our reseller losses were small as they've been in years -- in quarters, I should say, excuse me. So that's even showing an impact on that service revenue item.



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From a network improvement perspective, Randall mentioned the multiple awards that we're getting. Anybody who's heard Mike and I do presentations know that we test the speeds walking down the hallways

Before our presentations and it's working. And it's working. We get e-mails from investors and so forth. So it's having a real impact. That, we believe, is impacting our ability to gain and retain customers. It's going to take a while to make sure we get that story fully understood. It takes a little while to convince people. So we're optimistic that we'll see the benefit of that later in the year.

We're at 53% of our network build-out for FirstNet as of the end of the first quarter. We expect to get to 60% clearly by the end of the third quarter because that's the next billing milestone and payment milestone with FirstNet Authority. And as we've told you, we expect to get reimbursed, first year reimbursed, going to get that done. And we expect to do that. We're well ahead of schedule. Team's doing a great job in that. Putting all that spectrum into use at once may be causing me some interest expense pressure, but it's working. And it's working in the quality of the network.

5G, we're in 19 markets today, operational. Still using that 39-gigahertz millimeter wave. I will tell you, we still have plans to get a couple hundred. We have, if you will, a couple of hundred million on our 5G Evolution network coverage by the end of this year. But end of next year, we'll have over 200 million of our POPs covered on a 5G network. So our plans for 5G are going quite well. We -- as we mentioned earlier, we don't expect that revenue to come until next year and the year after, but we're working on a number of things, whether it's in the hospital, in coordinating medical centers, whether it's in the factories, whether it's doing a whole host of automated, if you will, campuses for our big customers. We're seeing lots of really good progress for that. But from a revenue perspective for a company of our size, we're still -- we're very optimistic. We're leading in 5G. But we'll see those revenue impacts growing over next year into the 2021 timeframe.

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

I would -- Simon, I'd add that this is the wireless piece. The network quality piece is probably the area within our business where I take more satisfaction than just about anywhere else. And this has been a long time coming. We've been investing billions. As you know, we've invested tens of billions of dollars in building the spectrum portfolio. And so bringing on FirstNet and having the opportunity to begin turning up all that spectrum as we're going across the country and turning up FirstNet is having exactly the impact that we hoped that it would have. And it is changing the value proposition for our customers.

The value proposition is now one of quality and speed and delivery of video. And we're not going out and doing a lot of aggressive promotions, and we're not doing pricing to try to get customers to stay and come on to the network. It is happening just organically and by virtue of the strategy that we implemented. The 5G Evolution product that we have out there, as we turn all this spectrum up and put the new technology on MIMO and so forth -- our competitors hate it, but it's having exactly the effect that you want it to have. Our customers see this tag and they go and do a speed check. And they're seeing 80, 90, 100, 150 meg speeds, depending on where they are. It is truly a step-change difference in product capability, and it's having exactly the effect that we had hoped.

And so of all the areas that I look at right now and say I'm pleased with, this is the #1 area that I'm most pleased with. Obviously, second would be getting the Entertainment Group EBITDA stabilized and actually growing, and we're feeling really good about that as well. But this is really, really an important accomplishment for us.

Operator

Your next question comes from the line of Phil Cusick from JP Morgan.

Philip A. Cusick - JP Morgan Chase & Co, Research Division - MD and Senior Analyst

Two follow-ups. Can you dig first into the wireless growth and help us quantify what FirstNet is doing for the sub line? And then second, a follow-up on the video side. Can you expand on your relationship with the NFL, and particular, on the exclusivity of SUNDAY TICKET?



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Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

Sure. Wireless growth, we're having a lot of success with FirstNet even with only 50% of the nation now completed in terms of the network build. And you heard 570,000 subscribers. And John articulated that we've hit a threshold where more and more of those are coming new on to the network. They're not just migrations on to our network. And what we are finding is the FirstNet community, we put some very attractive offers out there for their families. And so every FirstNet subscriber that comes on to the network, I think the latest number, John, is we're getting 2 family members with it?

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

Yes.

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

And so this is driving a not-inconsequential impact on subscriber gains, the network quality being the best and FirstNet being a main driver of it. So FirstNet is going to be a very important strategic element for us for a number of years to come, and we continue to be more enthused about it than when we won the bid and won the deal.

In terms of the NFL, I think we're not allowed to discuss much, but the exclusivity should remain as we go forward on DIRECTV. You probably saw news that the NFL Network was taken down on our U-verse network. And look, we're heavily invested in the NFL on DIRECTV, but we're limited to carrying the SUNDAY TICKET just on DIRECTV. And so our customers that have a high affinity to the NFL, we tend to have them over on DIRECTV.

When you look at the NFL Network, there's a cost attached to that. And when you consider the games on the NFL Network or the NFL Draft, our customers can watch the NFL Draft on ABC. They can watch the Thursday night games on Fox. And so it's all stuff we carry. And so the NFL Network was -- where a product, U-verse, that was not allowed to carry the SUNDAY TICKET. It just didn't really make sense to continue carrying it over there. So it will save some content cost, and we'll give our customers access to the NFL through other mediums. If they really are an NFL-centric customer, we'll move them to DIRECTV.

Philip A. Cusick - JP Morgan Chase & Co, Research Division - MD and Senior Analyst

Got it. And at one point, you talked about bending the content cost curve on DIRECTV. You re-signed Viacom. Is there something coming that you think might bend that curve? Or we should look at it sort of linear from here?

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

So we have nondisclosures generally on these deals. But what I would tell you is that the content cost or the content deals that we have negotiated over the last few months have all been curve vendors. And we feel good about where we're coming in. And I think the margins on Entertainment Group are reflecting that. So bottom line, I am satisfied with the progress that John Donovan and his team are making on the content deals as they're coming up and in getting them recrafted to make sure we can distribute them to all our various platforms and controlling the cost curve.

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

And remember, Phil, the ability to work with them on -- that's not at all. The content distributors have more advertising minutes than we as the distributor do. So if we can use our advertising resources to increase our ARPUs and our advertising dollars, like you've seen with Xandr's growth, and then we can offer that to the content guys, there's a different -- there's a solution to the situation where they can gain advertising revenues and not have the content costs but still be revenues for them. And both of us benefit as do the customers. And quite frankly, we're really excited



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about Viacom. As we said, we're working at Xandr with Viacom on things just like that. So there's solutions here that are -- can be mutually beneficial to all 3 of the parties: the distributors, the content providers and the advertisers. So it's a lot of work we're doing and the team is doing a great job. But we believe that there are solutions here that made sense for everybody.

Operator

Your next question comes from the line of Brett Feldman from Goldman Sachs.

Brett Joseph Feldman - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

On the slide where you show your fiber broadband net adds, what we can see is that there's been gradual improvement in that performance, which makes sense because you've been building out the fiber network. I was hoping you could give us just a little more insight into what's driving that. For example, to what extent has the mix of that been shifting from upgrades to maybe winning new customers? How do you see that trending as you complete the fiber build-out? And if you can give us any insight into the success you've had at bundling that fiber with some of your other projects, that would be really helpful.

John Joseph Stephens - *AT&T Inc. - Senior Executive VP & CFO*

Yes. So great, Brett, let me take a shot at it. And I appreciate you bringing this up because I should dovetail this in -- for our prior question. When you look at the Entertainment Group margins in total, broadband is really a driver. Broadband is really a grower. If you remember my comments, broadband growth this year-over-year quarter exceeded the challenges, the headwinds we faced from the local, voice and the other equipment revenues. So that's actually -- when you put broadband there, broadband's growth exceeded that. So broadband, specifically fiber-driven is doing well, and it is -- and it in itself is helping drive EBITDA margin improvement at Entertainment Group. That's one. Two, we'll continue to see some revenue growth on broadband throughout the year. Just like wireless, compares get a little bit more challenging in the second and third quarters, but we still expect to see ARPU growth and revenue growth. So feel really good about that.

Yes, you're right. We've kept about 25% of the available fiber out there. We've been pretty consistent that no matter how much more we put out, 1 million or 1.5 million a quarter, we continue to immediately utilize 25% of that because we've -- continued to add capacity and we'll finish off adding that capacity, at least from the FCC requirements we have in July. We'll then start to further penetrate that market. So we feel like we'll be able to grow it. If you think about the time frame, keeping up with 25% is a pretty good penetration rate when you continue to add as much fiber as we've had.

We see it in areas where we have the video, the wireless and the fiber together. Bundling is going well. It continues to give us an opportunity to participate and take market share in the broadband space. You are right. We continue to see, on the early stages, migrations of existing customers. But once again, as we get past that initial stage, we get in to be able to attract more and take share, which we've said in the past and we'll continue to see going forward.

So with that being said, I expect we'll get to around 14 billion or maybe just under that range by the end of June, end of July kind of a time frame to fulfill our FCC requirement. That will give us 22 million customer locations in total. But that 14 million, we'd expect to continue to see that 25% penetration very quickly and move up from there and get into an on-par market share with our competitors as we take share or convert more customers.

Let me stop at that and see -- Randall, if there's anything you want to add or anything I forgot?



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Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

No. I think you've covered it well. This is probably one of the more exciting areas of the business in terms of where we have invested heavily, and now we're seeing the fruits of the investment. And getting to 25% penetration, that's almost mechanical. To be candid with you, whenever we go into a neighborhood and turn up fiber, 25% comes fast and 50% is eminently achievable. And we actually think we can hopefully get beyond 50% as we continue to get this build completed. And I'm telling you, where we get AT&T Fiber, a video product and a mobile product, churn rates just drop. And the value effect of that is really, really powerful. Customers love it, and the services are all premium services. And so this is going to be a really important element of us as we go through the rest of this year in 2020 in terms of keeping the Entertainment Group EBITDA stable.

Operator

Your next question comes from the line of Mike McCormack from Guggenheim Partners.

Michael L. McCormack - Guggenheim Securities, LLC, Research Division - MD & Telecommunications Senior Analyst

Maybe just a quick comment on the wireless business. It sounds like you guys grew -- you're fairly aggressive in 1Q on the buy one, get one offers. Clearly, FirstNet is having a positive impact. But how should we think about, on a going-forward basis through 2019, the appetite for that trade-off between promotional activity, margin and phone net adds? And then secondly, on the broadband side, the IP broadband side, could you give us a sense -- I know you're going to be lapping that allocation -- the revenue allocation change. How should we think about the spot pricing in broadband sort of today versus, say, a year ago?

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

So let me take the first one. On the mobility margins and the perception of BOGOs and so forth, remember, our equipment revenues are really down. So in -- so that may have an effect depending upon on how any of our promotions are done on the BOGO stuff.

But let me say it this way. If you look at our results and you say service revenues were up about \$375 million, \$400 million, and our -- about \$375 million; and our EBITDA was about \$133 million, \$150 million; and then you say, I had noncash accounting rev rec commission and amortization in the rev rec and so forth of about \$200 million, effectively, of that \$375 million service revenue, \$350 million -- or almost \$350 million of it fell to the bottom line from making that accounting adjustment. So from that perspective, it won't be really effective in controlling cost, controlling promos, being prudent with advertising and promotional expense. So we feel good about the quality of our customer count net adds and the ability to do that. I mean I understand your question, Mike, but I don't want to leave you with the impression that somehow -- this was a very thoughtful process and focused on valued customers. And we, I believe, were really successful.

So I would tell you that the value of FirstNet, the quality experience of the market and the opportunity it provides and further geographic coverage -- and quite frankly, we're putting more distribution points out there with opening new stores. That's part of our investment that we're making that sometimes shows up in the expense line as opposed in the CapEx line. But we are expanding our stores in the places where we didn't have stores before. So all of that based on FirstNet, based on a solid -- very, very solid first quarter results, based on this expanded, if you will, geographic footprint and distribution footprint, we feel really good about wireless going forward.

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

That point John just made, as we build out FirstNet into these rural communities, as we deploy, we're turning up new distribution in these rural communities. And these tend to be communities that have had one option for the last number of years. And we're having a lot of success as we move into these smaller communities, set up new distribution and taking market share. So that's just another side benefit of the FirstNet build.



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John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

But with regard to the IP broadband side. I'd just refer you to the kind of the ARPUs, I think, that we got published out there with regard to this quarter being at about \$50 -- a little over \$50 on the broadband ARPU. It's about 8% growth. But if you compare it to next quarter, you'll see next quarter year-over-year, we jumped from first quarter to second quarter last year. And so that's all we're trying to tell you about. It's not a sensitivity at all about the success of the project. We feel really good about it. And we do feel like, as we get more of the fiber put in service, we have the opportunity to -- our customers will want higher speed, and they'll be willing to pay a fair price for those higher speeds. So we're optimistic about it. We're just being careful from a numerical comparison perspective. If you look at the first quarter last year, both on wireless and on broadband, to second quarter, you saw us step up in those ARPU numbers. And we just want to make sure the compares are right.

Michael L. McCormack - Guggenheim Securities, LLC, Research Division - MD & Telecommunications Senior Analyst

Great. And Randall, can you maybe just comment? We're seeing a lot of price increases across the board on over-the-top streaming video products. How does DIRECTV NOW sort of stand up against that? And in this landscape, how do you view price elasticity for your customer?

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

Yes. Mike, we made our move on OTT pricing and rationalizing the whole content lineup for our OTT product in the fourth quarter. And you've now seen most of the other players that have a streaming product out there follow. And I think we're getting to a place where the product, we all look at it and say, "Okay, this is a sustainable place." If you can get the advertising revenues to where we think we can get them, this is probably a sustainable level. It is, as you're seeing, highly price-sensitive. This is a segment of the market that had, by and large, left the linear product market because of pricing. And so as we came in with a \$40 product, you saw significant uptake, and it was largely people who had left the market. And as you begin to move the pricing and try to get the profit equation right, you saw some fall out.

But now we're in the market at this \$50 price point, and we're early on in terms of getting the new platform out there. It came out, I think, very end of March. But we're seeing good uptake on the new platform, the new pricing. As I said during the second quarter, you may still see the OTT product be negative in terms of subscribers as we continue to experience price increases on the base. But what we're seeing on the uptake of the new product with a new price point is giving us confidence. So we get to second half of the year, this thing ought to do decent growth. And so we're actually optimistic. But it is a very price-sensitive product, Mike. Make no mistake about it.

Operator

That question comes from the line of Michael Rollins from Citi.

Michael Rollins - Citigroup Inc, Research Division - MD and U.S. Telecoms Analyst

Two, if I could. First, as you look at the performance of full fiber subscribers when you made the upgrade, relative to the implied decline of customers with DSL and fiber-to-the-node, how are you think about what portion of your homes ultimately need to get the full fiber capability and how quickly you want to get there? And then secondly, you described the growth in fixed broadband ARPU as customers are buying up the higher-speed packages. Do you see a multiyear opportunity in the wireless segment to change the pricing model and charge higher prices for higher bit rate, especially as you introduce 5GE and then eventually full 5G?

Randall L. Stephenson - AT&T Inc. - Chairman, CEO & President

Yes. On the 5G piece, Mike, I will be very surprised if, as we move into wireless, the pricing regime in wireless doesn't look something like the pricing regime you see in fixed line. If you can offer a gig speed -- because there are some customers that are willing to pay a premium for 500 meg to 1 gig speed and so forth. And so I expect that to be the case. We're 2 or 3 years away from seeing that play out. Right now, from a 5G standpoint,



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what we're seeing in terms of adoption tends to be business. In fact, it's exclusively business for us right now. It's serving as a LAN replacement product. And we're having really impressive demand, where we turn up the 5G service from businesses basically saying, "We want to put a router in," and it becomes their LAN replacement. And so now as you begin to think about equipment, whether it be handsets or tablets or laptops that have 5G modems within them, which that will happen starting this year and really pick up over the next year, then that truly does become a LAN replacement. You don't even need the router at that stage. And so the idea that just like business customers pay more for more speed in a fixed line environment, we expect that there's going to be demand and that there will be price differentiation for speed as you move into a 5G environment.

In terms of fiber upgrades, we have, as you know, over the last 3 plus, 4 years, had the most aggressive fiber deployment program probably in the United States. And so we've been going at a really hot rate in putting fiber out. As I mentioned earlier, I think it was to Mike McCormack's question, the adoption on fiber deployment in terms of taking market share and customer upgrades is fairly mechanical. It doesn't take rocket science to figure out what this looks like as you deploy fiber. And so while we're going to kind of finish off this first phase of our fiber deployment between 5G and FirstNet and just our natural desire and preference for fiber on new builds, you're going to see fiber continue to be pushed into this network. And as business locations demand fiber, you're just going to see a capital area of fiber deployment continue over the next 4 or 5 years. And it's not going to go at the same pace you've been seeing it for the last 4, but it's going to continue and I don't see that stopping. And so I see our fiber opportunity just continuing to grow as we move 2020 through 2025.

Okay. Well, listen, I appreciate everybody joining us. And once again, punchline to this quarter is we have basically done exactly what we told you we would do at the Analyst Day and then again our January guidance. Debt reduction is right on track. Asset sales and asset monetizations are right on track. Our free cash flow forecast is actually ahead of schedule, and Entertainment Group is on track and actually ahead of schedule as well. So stay tuned. We'll be getting more details to you in terms of our WarnerMedia Day to come in the September, October timeframe. And I appreciate your time and look forward to talking to again. Thank you.

John Joseph Stephens - AT&T Inc. - Senior Executive VP & CFO

Thanks.

Operator

Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T Executive Teleconference. You may now disconnect.

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