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PRESENTATION

John Richard Shrewsberry - Wells Fargo & Company - Senior EVP & CFO

I'm not sure what to do with all the energy that, that video creates at 7:30 in the morning on a Tuesday. Thanks, everybody, for being here. This is our third time that we've hosted this event. It's been in the mountains in Utah for the last couple of years, and now we're in Vegas, and we'll be here for the next few years. I know this one will be even better than it was in the past, in part because it's a lot bigger, just like everything in Las Vegas, including the walk-up music. This year, it's grown -- our conference has grown as the largest TMT investor conference in the quarter, which we're happy about in terms of number of companies attending. We've about doubled from last year in terms of attendance, companies presenting, one-on-one schedule. I think we're up to 1,100 one-on-one meetings, which is what our investor clients are asking for and what our issuing clients are asking for.

We're excited that you're here. We think that this is a great testament to Wells Fargo's commitment to the TMT vertical. It's very important to us as -- from a business perspective and in terms of our own operations. This is one of the industry sectors where we get as much as we give. We're about a $9 billion a year technology spender ourselves. We're a top 10 IT spender in the world. That's increased meaningfully over the last couple of years as themes like mobility, digitization, big data, information security and other things have come right to the fore in our business. So it's brought us closer to our clients.

I meant -- our bank analyst, Mike Mayo is here because he recognizes, especially among big banks, technology is a giant difference maker. It makes a difference in how we manage risk, how we manage our costs, what our customer experiences, what our team member experiences and then with respect to safety, which helps us build long-term relationships like the ones that we have with the clients who are here, which we're happy about.

We spent a lot of money and put a lot of incremental investment in the banking side of technology. We've added a lot of talent. We've allocated more capital. We have tens of billions of dollars of capital allocated to the technology, to the TMT vertical. We've improved our rankings in TMT Research, we've increased the number of technology transactions we've underwritten this year. And I think our equity trading volumes are in the top 10 across technology, media and telecom at this point, and we're going to keep on going with that.

So thank you very much for joining us.

As I mentioned, this is the third year. We've changed things in part because of feedback we've gotten before. I know that Phil, in addition to curating the music, is going to be on everybody to get feedback about how this can continue to get better year after year. So when we ask, please provide that.

One of the things that we've heard is that people wanted to meet with more private companies. Obviously, this is largely about public issuers and investors and their securities. But because of the evolution of the capital formation and corporate life cycle and technology, small, medium and large private companies are very interesting. We've got more than 2 dozen private companies at the conference this year. So we hope you like that.

I mentioned we've signed up for the next 2 years. We're thrilled about that. Mark, you're -- the Tuesday and Wednesday after Thanksgiving, to come back to Las Vegas to this venue for that. I'm a Bay Area person. By this time next year, the Oakland Raiders will be here. They'll be the Las Vegas Raiders, maybe there'll be a home game that we can all attend on a Sunday.

So it's my pleasure to welcome to the stage, Jen Fritzsche, our Managing Director and telecom services analyst; and John Stephens, the Senior Executive Vice President and CEO of AT&T. John, among the community of CFOs, is a candidate for the most interesting man in the world for what's been going on at AT&T over the last year. This could be -- we put this first thing in the morning so that it would draw people because there's a lot to talk about. So please welcome Jen and John for a fireside chat.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Thank you. I said not a typical telecom conference when the who welcomes us, right? Well, thank you. Thank you, John Shrewsberry, for that nice introduction, and welcome, John Stephens. We're thrilled to open up the conference.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Thank you for having us.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

We're going to do the get out of the way legal disclosure, and then we're going to jump right into questions, okay?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Where's my card? Where's my card? Well, first of all, I want to thank John for the kind introduction. Secondly, all the telecom folks at Wells Fargo. I have my card, we can help you with that on the technology spend, we're here to help. We appreciate your business. But today, we're going to talk about things that are forward-looking. Some things will -- may happen or may not. They're subject to risks. We would advise you to go look at our public filings and the information on our website. And I think we've satisfied our safe harbor responsibility.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Great. Well, thank you, and welcome again. We're going to jump right into questions.

QUESTIONS AND ANSWERS

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Late October, I want to say October 29, AT&T released what some would say is an ambitious 3-year plan. How can you address how to do -- how do all areas of your business essentially contribute to this plan? And I guess I'll throw in where are the challenges to achieving this plan?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. Sure. So let's start with the revenue growth over the 3-year cycle, that 1% to 2% range growth. First and foremost, it's going to be mobility.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Mobility.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

You've seen service revenues grow for the first 9 months of this year just under 2%. And you've seen last 2 quarters, strong net adds in postpaid, voice, prepaid and a stabilization in our reseller business as well as continued growth in IoT. So service revenue growth is going to be a key component of that. When you have the FirstNet effect on our network as fast as -- now recognized as the fastest, now we have the best quality, the ability to expand product services, client customer base, that service revenues is critical.

Secondly, we expect a lot of equipment sales. The handset upgrade rates have been historically low for the last -- about 4 years. Last quarter, we were at about 4%. That would imply a 25 quarter life to a phone with new 5G technology coming out and what -- with AT&T having a national nationwide 5G coverage next year, we expect handset sales to pick up for people to take advantage of those new services. So that's mobility, both service, and quite frankly, equipment.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Right.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

We expect to continue to see really strong performance out of WarnerMedia. Think about HBO Max thinking about getting to 50 million customers out in 2025. But the progress up through there, the growth in revenue from that, that's another piece of the puzzle. We've seen real stabilization in Business Wireline and in total business solutions with the advent of wireless technologies, 5G on IoT. We expect continued solid performance there.

Our recent announcement with Mexico and our wholesale deal with Telefónica, an 8-year transaction that's going to allow us to carry their traffic on our network, it's going to bring a lot of wholesale revenues and real opportunities, quality for them and utilization of our network. We'll continue to see growth in broadband, and we'll continue to deal with the marketplace as it goes for dial tone and legacy and video services. But overall, those are the kind of the revenue growth drivers. When you look at EBITDA, mobility is going to be a strong part of that.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And mobility contributes to what percent of your -- and it's...

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Right now, it's about half -- just under half of our EBITDA. And so when you get that growing at a couple of percentage points, if you will, is what we're growing service revenue at today, and you can maintain cost at the same level, you can see tremendous EBITDA improvement growth.

Mexico's EBITDA improvement is going to be significant. With that wholesale arrangement as well as the trends that we're seeing, they're adding a lot of customers. They're the leading customer addition company. So it's a scale business, and we're getting to scale. That's going to add significantly. The merger synergies out of WarnerMedia, we're just starting those, $2.5 billion run rate by the end of the third year, so that will pick up. So all of those things can give us confidence as well as the next step, and that's some of the cost efforts we've got undergoing.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And any -- everyone has kind of a worry list. Any challenges you see in your seat where -- to achieving this business list?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. I mean it's a lot of hard work in this competitive environment. We have to deal with that. There's technology changes and new competitors. But quite frankly, that's been the case.

There's -- the economy has its ups and downs. We're seeing really strong consumer, which really drives the U.S. economy. We're seeing a more moderate or not as exciting business investment cycle right now. It's coming off some pretty high levels, so you got to be careful what you compare to. But quite frankly, the economy seems to be going well, and we have a lot of very resilient products and services. People are going to continue to use that mobile phone.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And then recurring revenues model?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. And they're going to continue to use their broadband. They're going to continue to use the services we provide. So we feel good about that. But yes, sure, there's always challenges.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it. The capital structure. You are the CFO, so I guess, you're on the hot seat here. And it's an interesting time for AT&T because you're certainly shifting your priority, you paid down a lot of debt. I mean remind me how many -- much in the last 9 months is the big number.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Since we closed the deal, by the end of this year, we'll have paid down about $30 billion or about 75%. And some very well-respected analysts have questions on that in the past about our debt levels, and I think we've responded very strongly.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

You did, you did. I will say Nicole (inaudible) by the whole way.

But now you're shifting to repurchasing of shares. That could, some would say, seem difficult to accomplish given the markets in which you compete. Why is now different?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Well, first and foremost, we have paid down 75% of the debt, $30 billion. We've gotten our quantum of debt down to a very manageable level, very comfortable level. We'll be in that 2.5 range at the end of the year. So we've done what we said we were going to do, and we've done really well. Now when you look at it, we're going to continue to pay down debt and we're going to continue to focus on getting our debt upgraded by the rating agencies, that's been a focus.

But it's time for a more balanced approach. When you have a dividend that's -- an after-tax dividend that's 5.25%, 5.5%, depending upon what day you look at it, and you've got ability today -- we're borrowing 30-year money at 4.25%, and it's tax deductible, so it's probably going to cost us closer to 3%. That cash cost of capital, whether it be equity or debt, has to be taken into account. In today's case, it's the cash savings from retiring.

Secondly, we did issue a lot of shares in the Time Warner transaction, and we're just looking to retire those. So that's the difference. We have that ability. The markets recognized it, and it's a good time to do that. We'll keep it balanced.

But I want to focus on we're going to get down to a 2 to a 2.25 net debt-to-EBITDA range, but on a 3-year cycle. We feel like that's a really comfortable range. I know to some folks, that may sound a little higher than tradition, but interest rates are -- when I took this job, interest rates were almost twice what they are today on the 10-year, right? And quite frankly, taxes we're 40% -- have been cut 40%. And when you're a capital-intensive company like us with expensing, taxes have actually been cut more than that. So when you adjust that, what was traditionally maybe a 1.5, 1.8 to a 2.0, we're really well below those traditional levels when you adjust for this really low tax rate environment for a capital-intensive company and this really low interest rate environment. So we feel very, very comfortable with that.

If things change, we'll change with them, but we feel very comfortable with it. So it's a balance. It's not a shift away from -- we're going to continue to pay down debt. But it is time to, if you will, retire some of the shares we issued.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And if I'm remembering correctly, November of '18, you outlined the plan to sell $6 billion to $8 billion in assets. You're well above that at this point.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes, we are.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Okay. So that has been something that's been...

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

So we have announced about -- there's probably $14 billion worth of different things we've done, whether it's -- some of it went through free cash flow, in the monetizations and receivables, whether it's the monetization of our tower option receivables. Some of the tower companies owe us some money on final payments from some of our tower transactions, and we got partners come in and invest in those partnerships to help us with that cash.

We've sold contracts for CME, for Puerto Rico, Game Show Network's been closed, Hudson Yards -- on and on. And we've got a lot -- we've got the regional sports networks. We're actively marketing the towers in the U.S. We're waiting to close -- we've got more towers...

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Could we see asset sales being the continued part of your forward strategy?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Portfolio analysis, these portfolio reviews going to be an ongoing. And quite frankly, with the cost work we're doing and the work the team's doing now, you will see that kind of naturally migrate to a product simplification process.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it. So obviously, the capital structure is important to the free cash flow, which is the heart of the AT&T story, in my view. I think that on a trailing 12-month basis, you have the right free cash flow, it's like $29 billion. I guess will you raise guidance? Are there additional receivable securitizations that could be realized? And importantly, in the free cash flow, at equation is capital intensity. So thoughts on that.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

So I'm not going to change the cash flow guidance. We're comfortable with our $28 billion range this year, feel really good about that.

Secondly, we're always looking at opportunities, as we've proven over the last 15, 18 months. We've proven that there's opportunities when you have a $500 billion balance sheet, you scrub it hard, you can find opportunities, and we'll continue to do that. So there's not going to be any slowdown in that.

With regard to capital intensity, you may have seen the announcement this morning about our FirstNet build -- has been really, really successful. And it's now covering 75% of the geography required. That's well ahead of schedule now, I think probably about somewhere between 6 and 9 months ahead of schedule. Team's doing a great job. When you think about that, that means we only have 25% left to build over the next 27 months or 25 months, excuse me. So we're well ahead of schedule on that.

So when you think about CapEx going forward, the accelerated fiber-to-the-prem build, getting us to 14 million is completed, we'll continue to spend money on fiber, but that accelerated build's been completed. Mexico and the 100 million LTE POPs is completed. We're shifting from a video where you roll a truck, roll one of our trucks and climb the side of a house to put up a satellite dish to rolling a UPS truck and delivering the AT&T TV equipment and it's self-installed. That's going to be significant capital efficiency.

And then, quite frankly, what we've done with the FirstNet is what we've climbed the tower, we put 3 different segments of spectrum up, 3 different bands at the same time. And we put equipment up, and not in every case, but -- and certainly, we're trying to do it in every case, I'll say it that way, putting 5G equipment up today. So even though we are going to turn it on with software next year, we are making those investments today. And so there's a natural process for us to adjust our capital spend, they're going to adjust our capital intensity. That goes on top of the software-defined network and network function virtualization and the things that we've been doing for 5 or 6 years to change our core telecom structure and make it more efficient. So yes, we see an opportunity.

I don't want to give anybody an impression we're not going to continue to invest in the business. We will, and we'll certainly invest in success-based opportunities with our customers. But we have an opportunity and certainly have an opportunity to hit our guidance next year with regard to capital intensity.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And so 2 clarification points on that. 5G, people say, "Oh, it's so expensive. How can they be slow? " But you're saying what you've done on the FirstNet, one-touch initiative is also prepping the network for 5G.

And then my second follow-up question, you mentioned the fiber. It's fair to -- I mean, I think there's a misnomer that fiber is not important to AT&T, yet you have the best, you have very strong track record in the -- penetration gains in those markets. Those both fair points to say fiber is still extremely important?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. So I'll take those -- let me go to the spectrum one or the FirstNet build. Climbing that tower of three band, AWS-3, the Band 14, the WCS all going up at once. The equipment is 5G-enabled equipment. So if you're going to climb that tower, I'll pay you for it, and I'll pay -- and we'll spend

more money than we normally would because it can be done so efficiently. And you can do things quicker because you only have to touch a tower once, so you get more done and they keep proving that to us, right? Came out and we were -- I was very pleased with the team's approach at 65% by the end of the third quarter. And heck, we're hoping to get 70% or maybe better by the end of the year, we're already at 75%. So they're -- that ability is then making next year's conversion. And this year, in the fourth quarter, we're going to have some -- we'll have 5G up on our core network this year. We'll have 5G on a nationwide basis, over 200 million POPs covered by the middle of next year. We couldn't do that unless it was a software upgrade for so many of the towers. And so yes, it has a real impact and real savings. It's causing us to invest some more money ahead of time, but I believe what money well spent.

On the fiber, absolutely. We have 22 million customer locations pass with fiber between business and consumer fiber-to-the-prem locations. So we truly believe in it, and it's really important for offload, for wireless. It's important for an extensive customer base who wants the security, the stability, the speeds and the reliability that fiber provides, whether it's on the business side or it's in my home. So it continues to be important.

What we have today is an opportunity to sell into about 10 million unsold on the fiber-to-the-prem and sell into literally millions of other locations on the business side, and we're focusing on selling in and satisfying customers' demands. If a customer -- business customer comes to us and wants to buy services from us on a fiber-based, we'll make those investments. I mean we have to make common sense.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Right.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

But the last piece, I'll tell you this. The reason fiber works differently for us than others is because I can use it 3x. I can use it for my consumers, I can use it for my business customers, and I can use it for my wireless backhaul.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

It's a multipurpose.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

So if we have our smart, talented network engineering team design it that we get multiple uses out of this -- we can be agnostic to the technology, but we can get multiple uses out of it, and that's what they're doing.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it. I want to shift to wireless because 50% of your EBITDA comes from this wireless. And really, it's, in many ways, the roots of AT&T. It's an interesting time in the competitive environment. You guys have grown very nicely in an extremely competitive environment. And maybe if you could just comment on how you see this environment. I mean a lot could change 3 months from now. If Sprint and T-Mobile is approved, DISH is coming in. There's questions on that. But how do you -- is that AT&T just staying in their lane? Or how do you respond to this?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Well, I think one of the way we view it is we're in a good spot, either way. And I will repeat the FirstNet build -- but the impacts of that are significant: fastest network, highest quality. We're getting tremendously increased capacity. So it's opening doors, not only for additional FirstNet customers, but resell arrangements and so forth, right?

And as you've seen in the last, specifically in the last 2 quarters, we've turned to growth in the postpaid voice. And for years, we've been leading the prepaid side. So for us, we feel like we're in a competitive environment today, and we're very well positioned differently. We probably have 50% more low-band spectrum, mid- and low-band spectrum than our nearest competitor, and 75% of it is built out in a very deep environment so -- and we feel very good about it.

Is there uncertainty in merger and market make up? Absolutely, but we feel really good about our ability to compete no matter what. On the same token, we've got some millimeter wave spectrum that gives us an ability to serve our business customers or IoT to do offloads in heavy traffic areas. So we feel very good about that.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it. And I know there's limited you can say about spectrum because there's quiet periods per se, but there was a delay in a mid-band spectrum auction, and AT&T could have a better balance sheet -- I mean, even better balance sheet at that. How do you -- any view on that delay event?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Certainly, as we continue to pay down debt, as we retire stock also, I expect our balance sheet to -- I expect the rating agencies will look to upgrade us. I really do. It just seems for what we've done over the last 18 months and what we plan to do over the next year, not to mention 3 years, expect that to happen. So from that perspective, I guess, the more important answer is, once again, we have 150 to 160 megahertz of medium- and low-band spectrum that we're putting in use today. So while spectrum is important and spectrum is needed, we are in a different position than any of the marketplace because of our historic ownership of spectrum and the investments we've made over the last 5 years, and quite frankly, because the FirstNet contract allows us to put it in service in a really efficient way. That will pay us dividends for years and years to come. Others will try to catch up, I'm sure, and I understand that and respectfully. But those things are tough to do, it's expensive to do. It takes time. You have to have spectrum. You have to go through -- enter a few mergers before, understand the challenges of those mergers so...

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And we are -- I know a lot of people in this room care about 5G from a technology standpoint as well as telecom standpoint. You guys have said you'll have nationwide 5G sub-6 network by the first half of next year, so first half of 2020. And you also have 5G+ live in over 20, 21 markets, I believe, for consumers. I guess what's the hardest part of this 5G build? I mean is it meshing it with the millimeter wave spectrum also that you have or (inaudible)?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

So I think the 5G+ millimeter wave, and we've got today about 600 megahertz nationwide millimeter wave. That's really a focus on, and we've had success at the Rush Hospital in Chicago or the manufacturing plant in Austin or AT&T Stadium in just outside Dallas and Arlington, Texas. And these applications that we're seeing where you need -- in our Atlanta location with -- we call 5G+ millimeter wave base, we have 2 gig speeds. So we are seeing these applications come, and they'll be focused on, first, business applications, automated factories, campus capabilities, entertainment capabilities in a sporting venue like an AT&T Stadium. It will focus there, then to other applications.

We will also use it for really high-traffic areas. So in our campus in downtown Dallas, we'll have 5G capabilities, and we'll use it to try to offload a lot of the traffic that comes with so many people being in 1 location. It will then grow, just like the market has grown when we went from 3G to 4G, when we used to use our phones for just talking, and then texting, and then e-mail. And now everybody is -- hopefully, everybody's watching HBO on their phone, right?

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

(inaudible) get to that, yes.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

And so just as that has happened, that will happen with 5G with augmented reality and virtual reality and with gaming and with all kinds of other applications where it leads to automated vehicles or other things. But it will all happen. That will take some time. That will follow, I think, in this case. It's going to be unusual adoption in this cycle because previously, the phones were out there before the networks are ready. And in our case, our network is going to be out there before all the applications (inaudible). We think that is a real positive for growth, and specifically growth on our network, because we're going to have this capability, this nationwide capability. Others talk about their abilities, but ours is going to be a 200 million POP on a very deep network.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And deep spectrum, like multiple tiers of spectrum, because you really have that base and then the mid, yes, and...

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

When we first come out, it'll be on a single tier, just in the first launch. But, yes, as we go through, we'll launch (inaudible). And quite frankly, as the phones come out, to be able to use it is that next level, which is why, once again, we think equipment revenues are going to rise.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And I know people think of 5G and the revenue opportunities that can come with it, but it is also a, "Build it, when it will come?" But from a cost standpoint, there's significant savings on your network using that spectrum more efficiently. Is that correct?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. Cost per megahert -- megabit carry -- goes way down, and it's really important. And that's important to your existing 170 million customer base, and giving them good service and retaining them, lowering churn. The best customer you have is one -- the best customer to get us 1.5 years, and so all of those kinds of things. So yes, it is really important, no matter what happens.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And is that also helped by -- you mentioned the network virtualization that AT&T has undertaken. You've almost moved from a hardware company to a software. So a lot of those costs are above the network. Is that -- I assume that makes your seat a better one.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Well, let me take it this way because I think it goes into some -- another area where we're getting a lot of questions on our cost efforts. For 5 years or so, 6 years, we've been doing a significant amount of work on network function virtualization, taking the hardware cost and separate the software and using software to upgrade the network on a much more efficient base. And network function virtualization, turning network functions into software. You've seen dramatic progress there. We've -- over the last 5 years, we probably had 6% to 8%, depending upon the year, I think, year-to-date through September, it was about 8% reduction in what we call our big-iron costs, our network operations or technology. We've really driven down those costs. And that's from that process. And we're going to continue to do that, okay?

But to hit our margins, goals and to hit our plan goals, we're going to do -- need to do some more. And that's why we bought -- Bill Morrow's heading up a cost -- kind of a cost czar process, where he's assembled teams, he's going out and collected best-in-class comparative data. He's done the analysis from every which way, if you will. And we've, quite frankly, gone out and identified areas where we really need to make improvements and where we think there's real opportunities for improvements.

We don't have those plans finalized. And [Bill's] been on the job for about 4 weeks. We'll give them a few more weeks, but it's well underway. And we do believe that there's a real opportunity out there. If you want to kind of put it into scope, our initial targets now are about 4% cost reduction in what we call our labor costs. The labor cost includes employees, includes nonpayrollers of some of our contractors, benefit costs and so forth. But we believe we can cut and achieve the savings from that of 4% for next year.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it. And Bill is reporting directly to the Board and Randall? Is that correct, yes?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

And to the -- he's reporting -- internally, he's reporting to John Stankey. He's also reporting to the Corporate Development Committee of the Board.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it. Okay.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

With -- so that's where we're going. If you want to think about where is that coming from, I talked about the portfolio, strategic review of our portfolio. Think about then taking that to a product simplification and look at the products -- we're 100-year-old company, right? We have a lot of products, a lot of SKUs, a lot of offerings. Can we simplify those? Can we focus on those that we don't really need to provide any more? Or we can migrate them to a new service. That's an area.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Got it.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

There's a process area. We spent a lot of capital. We have big networks. What processes can we further automate? What processes can we further streamline? That's a second area.

When you think about our customer service, think about our stores and how we sell and do we -- what's the split between retail stores and online and what's the ability to streamline our systems that our sales team has to use to streamline things, that's another opportunity, as well as doing that same thing for all the back office, for all the customer care. So we've got projects going on other way. We're optimistic. Or might as I say, we're targeting 4% cost reduction on top of what we were already doing, on top of the big iron run rate that's really important for us.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Now on to the fun stuff, HBO Max, we talked about in late October. I got to meet Conan O'Brien, it was very exciting. How does HBO Max impact your overall video strategy, which I also want to get into? And I guess the question becomes how do you balance exclusivity versus licensing content? And I -- just openly, is this going to be an accretive plan for AT&T?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. This is -- when we do any of our stretches, we go through an NPV. And certainly, this is a value-creating opportunity. We've been through that pressure testing.

What we think of it is we're going to become a company that has a very significant streaming opportunity, streaming product line, and quite frankly, a streaming delivery. That's HBO Max.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Yes. Yes.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Now -- well, we'll have HBO Max. And at some point in time, it will go to an AVOD and ad supported. Over time, you could see us add different components to it, but that streaming component is what it's about. That's where the market, to some extent, is today, but the market is further going, and we want to be there with our 170 million customer contact points between wireless and broadband and so forth as well as all the customer contact points on CNN and the Bleacher Report and the 150 million, almost 200 million contact points. We have a base that's dramatic, and so we feel real comfortable about the ability to touch enough customers to. And we feel really good about the quality of the product the team's put together. Bob Greenblatt and the entire team have put together a phenomenal product that you see.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

It was very -- yes.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

And so it is a key aspect, the key aspect of the video strategy going forward. And it will be certainly complementary to the AT&T TV process that we've launched and done test marketing and testing, beta testing in a number of in, I think, about 15 markets today. And we'll launch nationwide next year.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Next spring, I think you've said. Yes, okay. In -- on video, well, admittedly, you're not immune from linear churn and cord cutters, like the rest of the industry. You have experienced, I would say, higher video churn since the purchase of DIRECTV in 2015. Some of this has been certainly a macro shift, what's happening all around you. But in the bigger picture, how do you see that video segment fitting into the, we'll call it, the new AT&T?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Well, a couple of insights. It's an important segment. It's important for a lot of reasons. It's important from the information we get from customers, knowledge about what they want to watch, what's important, what gets viewed. It's important from a packaged and bundled services, to bundle

with our wireless, to bundle with our broadband. It's also really important on a stand-alone product basis in the sense that it's profitable. As you've seen, we've actually grown the EBITDA the first 9 months year-over-year. We've grown it slightly, so we feel really...

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

The guidance was for flat, so you've actually -- I mean...

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Yes. Today, we're adding -- we're sticking with our guidance of flat, but year-to-date, we've grown it. So I want to make sure -- what we've done on the customer side is really focused on long-term value opportunities for customers, what's good for them and what's good for us. And so having customers lock in for prices for 2 years and then have to raise them just to get content cost increases, it's just not something we're getting out of.

If you will, on the promotional side, we're doing much more focused promotions that will -- when you come in, you have a good sense of what the pricing is, what the quality of the delivery is and you're willing to stay with us. That transition that we're going through is -- it's tough, and we'll continue to go through it for the rest of this year. But we are optimistic we've hit the peak of losses in the third quarter, and we're looking for AT&T TV and this -- the anniversary of this new intake approach to much more rational product offerings to really help us going forward. It's a challenging business, but we need -- got broadband, fiber. You've got wireless. And when you got HBO Max, you got those kinds of tools to work with.

We're still committed to making this work and continuing to do the best we can to -- we're not giving any guidance on next year. But certainly, the hard work they've done to grow EBITDA year-to-date, I think it's lost sometimes in some people's comment about customers. And when you continue to grow EBITDA, I think you should, at least, take a breath and feel pretty good about the efforts that you're succeeding with.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

And (inaudible) mentioned broadband, some would argue in this world where people are changing content consumption to streaming, the broadband role in the ecosystem gets all the more important.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

That's right.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Do you agree with that?

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

We do. We think having those capabilities of having -- but remember, (inaudible) is -- comes in a variety of types, certainly fiber.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Yes. Your penetration is -- those markets...

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

We're -- we've got somewhere between 3.5 million and 4 million, just under 4 million customers on fiber, and we've got -- I can check that -- just a little less than 4 million, and we've got about 14 million capable. So we've got a lot of -- we got a lot of room to grow.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Right. Okay.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

So that's first thing. But quite frankly, we have a significant number of customers today who use their wireless phone as the broadband connection. And depending upon economic circumstances and value, you'll see some people that phone is really their device. They may not have a computer, it's their phone. And so we understand the necessity for both of those.

Now, quite frankly, to have a really great wireless network, you need a lot of fiber. And so they're complementary. They're not contradictory, they're complementary. So yes, we do believe that, that broadband capability is going to be important, but the ability to do it mobile-ly and to deliver things where people want, when they want them, how they want them, is going to be really -- continue to be really important.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

I asked about CapEx, and I just -- maybe it just ends here. Your CapEx guidance is $23 billion growth capital investment. Your reported CapEx seems about $20 billion trajectory, which would decrease just $1.3 billion year-over-year. Do you expect to improve your capital intensity in the future? (inaudible)

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

I do and I say it's because fiber-to-the-prem build -- Mexico's complete. The AT&T TV is going to be more efficient. Quite frankly, we haven't spent a lot of money on 5G equipment going into service today. So that's really important.

If I could turn on the capital -- other piece of the capital side. On our capital structure, we talked about continuing debt retirement, if you will, retiring about 70% of the shares, returning to our shareholders $75 billion over the next 3 years, $45 million in dividends and $30 billion in shares retired. There's a few other things going on. We continue to look at the debt markets. Today, we're looking at the debt markets and for most of bonds, and we continue to get really strong response. So we feel very good about that. Feel very good about our flexibility and with regard to refinancing our debt. We're continuing -- you asked the question about, is there any more asset monetizations...

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Yes.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

We're continuing to look at a second series of our tower receivables. We did one with one of the vendors that we had done business with, but we have done tower deals with other vendors. We're actively looking at that, and that could be a sign of our strength.

And quite frankly, we're looking at alternative capital structure -- pieces of the stack, like up just as a simple preferred stock, U.S.-based, kind of retail-focused preferred stock. People are looking for yield. If you can get a yield in a 5% and a 5.25% and guarantee them and let them play that level and there's demand for it, that would be something that we'd consider.

So I say all these things to you in the sense of -- we've done a lot of work with regard to the portfolio rationalization, but there's more to do and there's -- and we still have a ton of opportunities. We'll close the -- we expect to close Puerto Rico and CME next year, but we're actively looking at the [RSNs]. And we're actively looking at more tower transaction. We're actively looking at this tower option receivables.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Interesting. Okay.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

And my point is that I think a lot of people maybe were, and very respectfully, everybody were taken a little bit aback when we said $6 billion to $8 billion. And now it's like we got well past that. And then the sale, you're going to do it again. Well, it is a lot of hard work. It takes a lot of cooperation, a lot a team effort. But there is real opportunity with our company, and so we feel good about that capital piece. And that what gives us great comfort about paying down debt and retiring almost 10% of our stock over the next 3 years.

We feel very good about that ability because of the cash generation capabilities this really, really strong company has. And I think $20 billion in free cash flow this year is pretty good proof. Teams -- got a lot of people working real hard on it, and it's doing a good job for us.

Jennifer Fritzsche - Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst

Okay. Thank you so much. I really appreciate the time, and 2020 will be a really exciting year for AT&T. Thank you.

John Joseph Stephens - AT&T Inc. - Senior EVP & CFO

Thank you. Take care.
