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High Yield | Telecommunications Operators
North America

Sprint Corp (S)

Sept Q 2014: Lowering Ratings, Wrong (Guidance) Number, Competitors Busy Taking Share, Lowering Forecasts

- **Citi's Take** — We lowered our ratings on Sprint in our preview, but did not go far enough based on our downwardly revised forecasts. Sprint lowered its full year-guidance by about \$800 million (with two quarters remaining), and listed several new challenges which believe lengthen the turnaround time. We are not jumpers, but our model shows leverage rising and cash falling for at least the next three quarters. We lower our weighting and ratings on Sprint's credit.
- **Credit Implications** — We lower our weighting to Underweight owing to increased uncertainty, projected leverage increases, continuing cash usage, and relative value. We have no Buy rated bonds in Sprint's capital structure. We lower to ratings to Sell on Sprint's debt with relatively low coupons due 2019-2022 which trade near 6.5%. Specifically, we lower the 6.9s due 2019, the 7s due 2020, the 7.25s due 2021, and the 6s due 2022 to Sell. Sprint has used cash on an LTM basis since December 2012 and faces a highly competitive environment. Our model shows leverage rising and cash falling for at least the next three quarters. Sprint's network upgrade has caused disruptions which have increased churn and resulted in subscriber losses. Sprint has introduced several new plans to attract subscribers which may or may not be effective or margin accretive.

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Figure 1. Sprint Credit Pricing & Recommendations

UNDERWEIGHT			Maturity	Moody's / S&P	Amt Out (\$mm)	Current Prices			YTW Date
Cpn (%)	Description	Rating				Bid	YTW (%)	STW (bp)	
14.750	1st Lien	Sell	1 December 2016	Baa3 / BB+	300	124.125	2.68%	196	1 December 2016
9.000	Sr Gtd Nts	Neutral	15 November 2018	Ba2(S) / BB+(S)	3,000	116.500	4.47%	304	15 November 2018
7.000	Sr Gtd Nts	Neutral	1 March 2020	Ba2(S) / BB+(S)	1,000	109.750	4.89%	314	1 March 2020
6.000	Sr Nts	Sell	1 December 2016	B1(S) / BB-(S)	2,000	105.500	3.23%	249	1 December 2016
9.125	Sr Nts	Sell	1 March 2017	B1(S) / BB-(S)	1,000	112.500	3.47%	263	1 March 2017
8.375	Sr Nts	Sell	15 August 2017	B1(S) / BB-(S)	1,300	112.000	3.78%	275	15 August 2017
6.900	Sr Nts	Sell	1 May 2019	B1(S) / BB-(S)	1,729	104.000	5.87%	431	1 May 2019
7.000	Sr Nts	Sell	15 August 2020	B1(S) / BB-(S)	1,500	104.000	6.16%	432	15 August 2020
7.250	Sr Nts	Sell	15 September 2021	B1(S) / BB-(S)	2,250	103.750	6.56%	454	15 September 2021
11.500	Sr Nts	Neutral	15 November 2021	B1(S) / BB-(S)	1,000	126.500	6.71%	472	15 November 2021
9.250	Sr Nts	Neutral	15 April 2022	B1(S) / BB-(S)	200	115.500	6.58%	452	15 April 2022
6.000	Sr Nts	Sell	15 November 2022	B1(S) / BB-(S)	2,280	97.750	6.36%	417	15 November 2022
7.875	Sr Nts	Neutral	15 September 2023	B1(S) / BB-(S)	4,250	105.750	6.99%	476	15 September 2023
7.125	Sr Nts	Neutral	15 June 2024	B1(S) / BB-(S)	2,500	100.250	7.09%	477	15 June 2024
6.875	Sr Nts	Neutral	15 November 2028	B1(S) / BB-(S)	2,475	95.500	7.40%	481	15 November 2028
8.75	Sr Nts	Neutral	15 March 2032	B1(S) / BB-(S)	1,998	110.000	7.69%	505	15 March 2032

Source: Citi Research

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 2. Sprint Capital Structure & Liquidity

	9/30/14 2Q14	Gross Leverage	Net Leverage	Bid Price	YTW	YTM Date	Rating
Cash & Cash Equivalents	5,302						
\$3,300MM RC @ L+225bp due 2/28/2018	0						
Export Development Canada Facility (Tranche 2) 5.49% due '	500						
14.75% 1st Lien Clearwire notes due 12/1/2016	300			\$124.125	2.68%	1 December 2016	Sell
Secured Debt	800	0.1x	-0.7x				
9% Gtd. Notes due 11/15/2018	3,000			\$116.500	4.47%	15 November 2018	Neutral
7% Gtd. Notes due 3/01/2020	1,000			\$109.750	4.89%	1 March 2020	Neutral
Secured & Gtd. Debt	4,800	0.8x	-0.1x				
6% Sr. Notes due 12/06/2016	2,000			\$105.500	3.23%	1 December 2016	Sell
9.125% Sr. Notes due 3/01/2017	1,000			\$112.500	3.47%	1 March 2017	Sell
8.375% Sr. Notes due 8/15/2017	1,300			\$112.000	3.78%	15 August 2017	Sell
6.9% Sr. Notes due 5/01/2019	1,729			\$104.000	5.87%	1 May 2019	Sell
7% Sr. Notes due 8/15/2020	1,500			\$104.000	6.16%	15 August 2020	Sell
7.25% Sr. Notes due 8/15/2021	2,250			\$103.750	6.56%	15 September 2021	Sell
11.5% Sr. Notes due 11/15/2021	1,000			\$126.500	6.71%	15 November 2021	Neutral
9.25% Sr. Notes due 4/15/2022	200			\$115.500	6.58%	15 April 2022	Neutral
6% Sr. Notes due 11/15/2022	2,280			\$97.750	6.36%	15 November 2022	Sell
7.875% Sr. Notes due 8/15/2023	4,250			\$105.750	6.99%	15 September 2023	Neutral
7.125% Sr. Notes due 6/15/2024	2,500			\$100.250	7.09%	15 June 2024	Neutral
6.875% Sr. Notes due 11/15/2028	2,475			\$95.500	7.40%	15 November 2028	Neutral
8.75% Sr. Notes due 3/15/2032	2,000			\$110.000	7.69%	15 March 2032	Neutral
8.25% Sr Cmts due 12/1/2040	629						
Other	2,353						
Total Debt	32,266	5.2x	4.3x				
Market Equity Value	24,462		3.9x				
less: Cash & Cash Equivalents	(5,302)						
Enterprise Value	51,426		8.3x				
Liquidity							
Cash & Cash Equivalents	5,302						
Availability Under Revolver	2,378						
Total	7,680						

Source: Company Reports and Citi Research Estimates

We have no Buy rated bonds in Sprint's capital structure.

Sprint's \$32 billion debt is supported by \$24 billion market equity which provides 1.6x asset coverage.

Sprint has over \$7 billion available liquidity and no material debt maturities before December 2016 when \$2,000 6% senior notes are due.

Sprint has used cash on an LTM basis since December 2012.

September Quarter Review & Outlook

Conference Call Highlights

Sprint opened the conference call with the following: "We have started our transformational journey. While the company continues to face headwinds..."

Sprint materially lowered its full year EBITDA guidance to \$5.8 – 5.9 billion from \$6.7 – 6.9 billion. Sprint attributed this to lost postpaid customers and lower ARPU.

Sprint provided no formal 2015 EBITDA guidance but suggested "neutral to modestly higher compared to 2014".

Sprint plans to eliminate \$1.5 billion of costs versus the 2014 spend, including eliminating 2,000 additional workforce positions. Do you have good visibility into these \$1.5 billion costs? Yes. We note \$1.5 billion is about 10% annual gross profit.

September represented the first year-over-year growth postpaid net adds in 2014 and the "highest prime gross add mix in eight years".

Sprint has turned its focus to higher value and higher ARPU postpaid phone customers and away from the company's recent focus on tablets.

Sprint expects churn to remain elevated in the December quarter owing to competition and involuntary churn.

Sprint focused a meaningful portion of the call talking about prime customer focus and improving credit profile for its customers.

Sprint has recently revised the terms of its revolving credit facility to provide additional flexibility.

Sprint's go to market strategy will focus on value, clarity and simplicity.

Sprint affirmed its \$6 billion capex plans which are \$2 billion lower than prior management targeted.

What does Sprint think about the wireline strategic value? Open to strategic interest.

Figure 3. Sprint Financial Summary & Forecasts

	Fiscal Year End			Quarterly				LTM	Fiscal Year End	
	3/31/2012	3/31/2013	3/31/2014	9/30/2014	12/31/2014	3/31/2015	6/30/2015	9/30/2014	3/31/2015	3/31/2016
	2012A	2013A	2014A	2Q14	E-3Q14	E-4Q14	E-1Q15	LTM	2014E	2015E
Operating Statistics										
Net operating revenues	\$34,100	\$35,404	\$35,575	\$8,488	\$8,908	\$8,507	\$8,580	\$35,294	\$34,692	\$34,866
Sales Growth Y/Y (%)	4.0%	3.8%	0.5%	(2.2%)	(2.6%)	(4.1%)	(2.4%)	(0.2%)	(2.5%)	0.5%
EBITDA	\$4,771	\$5,092	\$5,765	\$1,386	\$1,046	\$1,395	\$1,355	\$6,211	\$5,654	\$5,723
Margin	14.0%	14.4%	16.2%	16.3%	11.7%	16.4%	15.8%	17.6%	16.3%	16.4%
Capital Expenditures	\$3,269	\$4,914	\$6,937	\$1,143	\$1,250	\$1,250	\$1,250	\$5,846	\$4,889	\$5,000
% Revenue	9.6%	13.9%	19.5%	13.5%	14.0%	14.7%	14.6%	16.6%	14.1%	14.3%
Balance Sheet										
Cash & Cash Equivalents	\$7,572	\$7,769	\$6,190	\$5,302	\$4,304	\$4,178	\$3,046	\$5,302	\$4,178	\$2,532
Secured & Gtd. Debt	\$4,981	\$4,981	\$4,800	\$4,800	\$4,800	\$4,800	\$4,800	\$4,800	\$4,800	\$4,800
Total Debt	\$22,232	\$24,500	\$32,778	\$32,266	\$32,266	\$32,266	\$32,266	\$32,266	\$32,266	\$32,266
Net Debt	\$14,660	\$16,731	\$26,588	\$26,964	\$27,962	\$28,088	\$29,220	\$26,964	\$28,088	\$29,734
Credit Statistics										
Total Secured & Gtd Debt/EBITDA	1.0x	1.0x	0.8x	LTM	LTM	LTM	LTM	0.8x	0.8x	0.8x
Total Debt/EBITDA	4.7x	4.8x	5.7x	5.2x	5.3x	5.7x	6.2x	5.2x	5.7x	5.6x
Net Debt/EBITDA	3.1x	3.3x	4.6x	4.3x	4.6x	5.0x	5.6x	4.3x	5.0x	5.2x

Source: Company Reports and Citi Research Estimates

Projection Update

Sprint introduced a number of new variables into its forecast mix this time including: involuntary churn to improve customer credit quality; reduced focus on tablets which have lower ARPU and value; increased focus on becoming the value leader; \$1.5 billion in cost reduction actions; Sprint highlighted over \$5.8 billion in liquidity and no significant maturities until December 2015; and management claims “we have started a transformational journey”. As a result, we materially lowered our EBITDA forecasts and modestly reduced our sale estimates.

Our revised December quarter forecasts include: \$8,908 million sales (prior: 9,194); and \$1,250 million EBITDA (prior: 1,344).

Our revised 2015 forecasts include: \$34,692 million sales (prior: 35,443); and \$5,654 million EBITDA (prior: 6,504); 5.7x leverage; and 5.0x net.

Our revised 2016 forecasts include: \$34,866 million sales (prior: 36,868); and \$5,723 million EBITDA (prior: 7,010); 5.6x leverage; and 5.2x net.

September Quarter Review

Sprint's \$8,488 million sales were below the \$8,668 million consensus.

On a year-over-year basis, Sprint lost 983k postpaid customers and 835k prepaid customers.

On a year-over-year basis, Sprint postpaid ARPU declined 5.4%, while prepaid ARPU increased 6.5%.

Figure 4. Sprint Revenue Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 1Q14	9/30/2014 2Q14	Change	
				Y/Y	Q/Q
Net operating revenues	\$8,681	\$8,789	\$8,488	(\$193)	(\$301)
Change				-2.2%	-3.4%
Postpaid service revenue	\$5,835	\$5,523	\$5,377	(\$458)	(\$146)
Change				-7.8%	-2.6%
Wireless equipment revenue	\$710	\$1,106	\$1,039	\$329	(\$67)
Change				46.3%	-6.1%
Prepaid service revenue	\$1,160	\$1,221	\$1,197	\$37	(\$24)
Change				3.2%	-2.0%
Wholesale service revenue	\$131	\$163	\$165	\$34	\$2
Change				25.7%	1.0%
Wireline Revenue	\$777	\$746	\$708	(\$69)	(\$38)
Change				-8.9%	-5.1%
Postpaid Ending subscribers	30,906	30,259	29,923	(983)	(336)
Change				-3.2%	-1.1%
Postpaid Net additions overall	(535)	(245)	(336)	199	(91)
Change				-37.2%	37.1%
Postpaid Churn	2.1%	2.1%	2.2%	0.1%	0.1%
Change				6.2%	6.2%
Postpaid ARPU overall	\$63.69	\$61.65	\$60.24	(\$3.45)	(\$1.41)
Change				-5.4%	-2.3%
Prepaid Ending subscribers	16,003	15,188	15,168	(835)	(20)
Change				-5.2%	-0.1%
Prepaid Net additions	28	(619)	(20)	(48)	599
Change				-171.4%	-96.8%
Prepaid Churn	3.8%	4.5%	3.8%	0.0%	-0.7%
Change				0.8%	-15.3%
Prepaid ARPU	\$26.04	\$27.97	\$27.73	\$1.69	(\$0.24)
Change				6.5%	-0.9%

Source: Company Reports and Citi Research Estimates

Sprint's \$1,386 million EBITDA was below the \$1,662 million EBITDA.

EBITDA margin declined 446bp sequentially to 16.3% owing primarily to a 476bp decline in wireless EBITDA margin.

Figure 5. Sprint EBITDA Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 1Q14	9/30/2014 2Q14	Change	
				Y/Y	Q/Q
Net operating revenues	\$8,681	\$8,789	\$8,488	(\$193)	(\$301)
Change				-2.2%	-3.4%
EBITDA	\$1,343	\$1,827	\$1,386	\$43	(\$441)
Change				3.2%	-24.1%
EBITDA Margin (%)	15.5%	20.8%	16.3%	86 bp	-446 bp
Change				5.5%	-21.4%
Wireless EBITDA	\$1,206	\$1,793	\$1,370	\$164	(\$423)
Change				13.6%	-23.6%
Wireless EBITDA Margin	15.4%	22.4%	17.6%	222 bp	-476 bp
Change				14.5%	-21.3%
Wireline EBITDA	\$117	\$35	\$27	(\$90)	(\$8)
Change				-76.9%	-22.9%
Wireline EBITDA margin	15.1%	4.7%	3.8%	-1124 bp	-88 bp
Change				-74.7%	-18.7%
Gross Profit	\$3,772	\$4,111	\$3,687	(\$85)	(\$424)
Change				-2.3%	-10.3%
Gross Margin (%)	43.5%	46.8%	43.4%	-1 bp	-334 bp
Change				0.0%	-7.1%
Selling, general and administrative	\$2,548	\$2,284	\$2,301	(\$247)	\$17
Change				-9.7%	0.7%
SG&A (% of revenue)	29.4%	26.0%	27.1%	-224 bp	112 bp
Change				-7.6%	4.3%
Depreciation & Amortization	\$1,524	\$1,281	\$1,294	(\$230)	\$13
Change				-15.1%	1.0%

Source: Company Reports and Citi Research Estimates

Sprint's free cash flow was negative \$115 million in the quarter, a \$530 million improvement year-over-year.

Working investment gains boosted cash flow by \$352 million in the quarter.

Figure 6. Sprint Cash Flow Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 1Q14	9/30/2014 2Q14	Change	
				Y/Y	Q/Q
EBITDA	\$1,343	\$1,827	\$1,386	\$43	(\$441)
Change				3.2%	-24.1%
Operating Cash Flow	\$1,196	\$679	\$1,028	(\$168)	\$349
Change				-14.0%	51.4%
Capital Expenditures	\$1,841	\$1,246	\$1,143	(\$698)	(\$103)
Change				-37.9%	-8.3%
Operating Cash Flow less Capex	(\$645)	(\$567)	(\$115)	\$530	\$452
Change				-82.2%	-79.7%
Change in Working Investment	\$308	\$51	\$660	\$352	\$609
Change				114.3%	1194.1%

Source: Company Reports and Citi Research Estimates

Sprint's leverage was essentially flat sequentially at 5.2x and 4.4x net.

Figure 7. Sprint Leverage Review

(\$ in millions)	9/30/2013 3Q13	6/30/2014 1Q14	9/30/2014 2Q14	Change	
				Y/Y	Q/Q
EBITDA	\$1,343	\$1,827	\$1,386	\$43	(\$441)
Change				3.2%	-24.1%
Cash & Cash Equivalents	\$10,544	\$5,493	\$5,302	(\$5,242)	(\$191)
Change				-49.7%	-3.5%
Secured Debt	\$3,831	\$800	\$800	(\$3,031)	\$0
Change				-79.1%	0.0%
Secured & Gtd. Debt	\$7,831	\$4,800	\$4,800	(\$3,031)	\$0
Change				-38.7%	0.0%
Total Debt	\$33,551	\$32,494	\$32,266	(\$1,285)	(\$228)
Change				-3.8%	-0.7%
Net Debt	\$23,007	\$27,001	\$26,964	\$3,957	(\$37)
Change				17.2%	-0.1%
Total Secured Debt/EBITDA	0.7x	0.1x	0.1x	-0.6x	0.0x
Change				-82.7%	-0.7%
Total Secured & Gtd Debt/EBITDA	1.5x	0.8x	0.8x	-0.7x	0.0x
Change				-49.2%	-0.7%
Total Debt/EBITDA	6.5x	5.3x	5.2x	-1.3x	-0.1x
Change				-20.2%	-1.4%
Net Debt /EBITDA	4.5x	4.4x	4.3x	-0.1x	0.0x
Change				-2.8%	-0.8%

Source: Company Reports and Citi Research Estimates

Appendix A-1

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% of companies in each rating category that are investment banking clients	75%	63%	46%
Citi Research US High Yield Issue Coverage	31%	58%	11%
% of companies in each rating category that are investment banking clients	71%	79%	65%

Sprint Nextel Corp (S_CRD) — Issuer Portfolio Weighting and Issue Rating History

High Yield Credit Research

Analyst: David Phipps

Issuer		Issue			
Weighting	Date	Coupon	Description	Maturity	Date
MW	11-Oct-12	6.000%	Sr Nts	01-Dec-16	Neutral (2)
OW	11-Jul-13				Sell (3)
MW	08-Jul-14	9.125%	Sr Nts	01-Mar-17	Neutral (2)
		8.375%	Sr Nts	15-Aug-17	Sell (3)
		7.000%	Sr Unsec Nts	01-Mar-20	Neutral (2)
		11.500%	Sr Nts	15-Nov-21	Neutral (2)
					Buy (1)
					Neutral (2)
		9.250%	Sr Nts	15-Apr-22	Neutral (2)
					Buy (1)
					Neutral (2)

6.900%	Sr Nts	01-May-19	Neutral (2) Buy (1) Neutral (2)	11-Oct-12 11-Jul-13 08-Jul-14
6.875%	Sr Nts	15-Nov-28	Neutral (2) Buy (1) Neutral (2)	11-Oct-12 11-Jul-13 24-Oct-14
8.750%	Sr Nts	15-Mar-32	Neutral (2) Buy (1) Neutral (2)	11-Oct-12 11-Jul-13 24-Oct-14
5.950%	Sr Srl Redem Nts	15-Mar-14	Neutral (2) NC	11-Oct-12 19-Nov-12
7.375%	Sr Srl Redem Nts	01-Aug-15	Neutral (2) NC	11-Oct-12 19-Nov-12
12.000%	2nd Lien Nts	01-Dec-17	Sell (3) NC	11-Jul-13 07-Jan-14
14.750%	1st Lien Nts	01-Dec-16	Sell (3)	11-Jul-13
12.000%	1st Lien Nts	01-Dec-15	Sell (3) NC	11-Jul-13 07-Jan-14
9.000%	Sr Unsec Nts	15-Nov-18	Neutral (2)	11-Jul-13
7.000%	Sr Nts	15-Aug-20	Buy (1) Neutral (2)	06-Sep-13 08-Jul-14
6.000%	Sr Nts	15-Nov-22	Buy (1) Neutral (2)	06-Sep-13 08-Jul-14
7.250%	Sr Nts	15-Sep-21	Buy (1) Neutral (2)	28-Oct-13 08-Jul-14
7.875%	Sr Nts	15-Sep-23	Buy (1) Neutral (2)	28-Oct-13 24-Oct-14
7.125%	Sr Nts	15-Jun-24	Buy (1) Neutral (2)	07-Feb-14 24-Oct-14

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