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VZ - Q4 2013 Verizon Earnings Conference Call

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OVERVIEW:

VZ reported 4Q13 GAAP EPS of \$1.76.

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PRESENTATION

Operator

Good morning and welcome to the Verizon fourth-quarter 2013 earnings conference call. (Operator Instructions) It is now my pleasure to turn the call over to your host, Mr. Michael Stefanski, Senior Vice President, Investor Relations.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

Thanks, Evan. Good morning and welcome to our fourth-quarter 2013 earnings conference call. This is Mike Stefanski and I am here with our Chief Financial officer, Fran Shammo. Thank you for joining us this morning.

Before we get started let me remind you that our earnings release, financial and operating information, the investor quarterly, and the presentation slides are available on our investor relations website. Replays and a transcript of this call will be made available on our website.

I would also like to draw your attention to our safe harbor statement and other legends on slides two and three. Information in this presentation contains statements about expected future events and financial results that are forward looking and subject to risks and uncertainties. Discussion of factors that may affect future results is contained in Verizon's filings with the SEC, which are also available on our website.

This presentation contains certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are also available on our website.

Before Fran takes you through the details of our results, I would like to cover a few special items that are included in our reported results. These are displayed on slide four.

For the fourth quarter we reported earnings of \$1.76 per share on a GAAP basis. This includes several significant non-operational items that I would like to highlight. The largest item is a pretax gain of \$6 billion related to the year-end mark-to-market adjustment of pension and OPEB liabilities.

This favorable accounting adjustment is primarily non-cash and is caused by an increase in the discount rate, changes in actuarial assumptions, and a greater-than-projected return on plan assets. On an after-tax basis this gain amounted to \$3.7 billion or \$1.29 per share.

Partially offsetting this favorable item were pretax charges of \$865 million related to the transaction to acquire Vodafone's 45% stake in Verizon Wireless. These transaction costs include net incremental interest expense of \$616 million related to the debt raise in connection with the acquisition and a bridge financing and other costs of \$249 million. On an after-tax basis these transaction charges totaled \$540 million or \$0.19 per share.

Excluding these non-operational effects, adjusted earnings per share was \$0.66 in the quarter compared with \$0.38 a year ago, which included a \$0.07 per share charge for the direct impact from Super Storm Sandy. For the full year, adjusted earnings per share were \$2.84 compared with \$2.24 last year, an increase of 26.8%. If you exclude the Sandy impact from last year, the increase was 22.9%.

The quarterly growth rates disclosed in this presentation are on a year-over-year basis unless otherwise noted as sequential. Also, the results in growth rates exclude the effect of the non-operational items.

With that I will now turn the call over to Fran.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Thanks, Mike. Good morning, everyone, and Happy New Year. Before we get into the details I would like to start with an overview to put our results in the proper context.

2013 was a great year for Verizon from both a strategic and financial perspective. Of course, the big strategic milestone was in our agreement to purchase Vodafone's 45% stake in Verizon Wireless, which will give us sole ownership of the best asset in the global wireless industry.

We have all the necessary financing in place. The special shareholder meetings for both companies are scheduled for one week from today on January 28 and a closing is planned for February 21. As we have stated, the transaction will be accretive to earnings per share by about 10% on day one. Full ownership will also provide access to all the cash flows and give us greater flexibility to develop converged solutions without any integration and due diligence risks.

Our strategy is to build upon the foundation and strength of our network assets as the platforms for the future growth and innovation. To that end, we are extremely well positioned in the center of the trends that are driving growth in our industry: mobility, broadband, video, cloud services, and security. Sole ownership of Verizon Wireless, along with our portfolio of other assets, will enable us to better leverage our capabilities across the entire business.

In Wireless we completed our LTE coverage build and continue to invest in our 4G network to take advantage of the significant opportunities enabled by this technology as we innovate around our customer solutions. In 2013 we further strengthened our portfolio of enterprise strategic services with the development of a new cloud services product suite, the launch of a mobile healthcare platform, and several targeted acquisitions which will enhance our capabilities in mobile video delivery. Collectively, these moves further strengthened the business and improved our competitive position in key areas of growth.

Underlying these strategic imperatives has been consistently strong operational and financial performance driven by solid execution and a disciplined focus on meeting our financial objectives. In 2013 we achieved or exceeded all of our key financial targets, delivering on what we said in January of 2013.

In Wireless we had an excellent year. We added 4.1 million new postpaid connections, generated service revenue growth of more than 8%, and drove a 15% increase in EBITDA. Our growth in EBITDA was significant, \$4.5 billion in absolute terms, and we expanded our annual service EBITDA margin nearly 300 basis points to 49.5%, squarely within our 49% to 50% guidance for the full year.

In FiOS we increased our penetration of data and video services by adding more than 600,000 new customers during the year. The scale of our FiOS business and the popularity of our FiOS quantum speeds drove annual consumer revenue growth of 4.9%, up sharply from 3.2% in 2012.

In the enterprise space, in spite of continued economic challenges, strategic services revenue grew 4.6% in 2013. In terms of Wireline profitability, we guided to a flat EBITDA margin and that is what we produced at 22.2%.

In the area of capital spending, we met our revised guidance of \$16.6 billion which was up 2.7% over 2012. Even with that increased spending level, we improved our overall CapEx-to-revenue ratio as we said we would.

2013 was a great year of significant earnings and free cash flow growth. Adjusted earnings per share increased to \$2.84, up over 26% for the year. Our free cash flow growth was also very significant, increasing by \$6.9 billion to \$22.2 billion, an increase of 45% from 2012.

In terms of shareholder value, we generated a total return of 18.6% in 2013 through a combination of stock price appreciation and dividends. For the seventh consecutive year our Board of Directors approved a dividend increase indicating their confidence in our future cash flows and earnings growth.

From my perspective, 2013 was a great year of execution resulting in impressive customer growth and significant improvements in profitability and cash flows. Now let's look at our fourth-quarter and full-year performance in more detail starting with consolidated results on slide six.

Total operating revenue grew 3.4% in the fourth quarter, continuing our consistent top-line growth trend. For the year, we added \$4.7 billion to consolidated revenue, an increase of 4.1%. On a full-year basis the increase in consolidated revenues along with effective cost management resulted in more than 21% growth in adjusted operating income.

On the same adjusted basis consolidated EBITDA increased \$4.6 billion, up 12.3% for the year. Our adjusted EBITDA margin expanded 260 basis points to 34.9%, the highest consolidated margin in eight years.

As we highlighted earlier, adjusted earnings per share in the fourth quarter of \$0.66 was significantly higher than a year ago. Our earnings performance has been very strong and very consistent with double-digit year-over-year growth throughout 2013.

Now let's move into a review of the segments starting with Wireless on slide seven.

Our consistent investment in Wireless is the foundation of our success and drives our leadership and network quality, reliability, and the overall customer experience. We will continue to build on our network advantage in 4G LTE by deploying capital to increase capacity and density to our network.

Our fourth-quarter and full-year Wireless results were excellent. We continued the strong momentum built during the year and finished very strong. Total Wireless revenues grew by \$5.2 billion in 2013 and totaled \$81 billion, representing two-thirds of Verizon's consolidated revenue. We sustained our strong service revenue performance with 8% growth in the fourth quarter, making this our fifth consecutive quarter of at least 8% growth.

For the year, service revenue grew 8.3%. We generated \$8.3 billion of EBITDA in the fourth quarter, up 22.6% from the same quarter last year. Our service EBITDA margin in the quarter was 47% compared with 41.4% in the fourth quarter of 2012.

For the year, EBITDA grew to \$34.2 billion, up \$4.5 billion or 15%. This is a very impressive accomplishment and a testament to the efficiency of our network and our continuous focus on improving productivity and efficiency throughout the business by applying our Verizon Lean Six Sigma principles. Our 2013 EBITDA service margin of 49.5% improved by 290 basis points, a very significant expansion, and is squarely within the guidance we provided during the year.

The other point I would emphasize is the consistency of our Wireless profitability. We have posted margins of 49% or higher in the five of the last seven quarters. Now let's turn to a more detailed look at Wireless revenue per account beginning on slide eight.

Service revenue growth continued to be driven by more customers and devices, increase of data usage, and smartphone penetration. Our Share Everything Plans are doing exactly what we expected -- driving device adoption and stimulating higher usage -- resulting in increases in both the number of devices and revenue per account.

During the fourth quarter, retail postpaid revenue per account, or ARPA, grew 7.1% to more than \$157 per month. We have seen consistent growth in this metric. For the full year ARPA was up nearly \$10 or 6.9%. We ended the quarter with 35.1 million postpaid accounts and average connections per account grew from 2.64 to 2.76, an annual increase of 4.5%.

As we have said, customer adoption of our Share Everything Plans has been exceptional. In just 18 months more than 46% of our postpaid accounts are on these plans. In 2013 we effectively doubled the number of accounts on Share Everything from 8.1 million to 16.2 million. The value proposition is simple and straightforward and customers recognize the value of shared data across multiple devices.

Let's take a closer look at connections growth on slide nine.

We had a strong quarter of quality customer growth. Retail net additions totaled 1.7 million, postpaid net adds were 1.6 million, and prepaid were 80,000. In terms of the makeup of our postpaid net adds, we added 1.4 million new 4G smartphone customers. Total phone net adds were 824,000 when you include the net change in 3G smartphone and basic phone customers.

We had a very strong quarter of Internet device growth with 675,000 net adds, 625,000 of which were tablets. The remaining net adds of about 74,000 were primarily home phone connect. As usual, we finish the year with strong customer growth and have great momentum heading into 2014.

To recap the full year, we had a total of 4.1 million new postpaid net adds and 4.2 million new 4G LTE smartphone customers. We added 1.8 million new Internet devices, with tablets representing about 1.5 million of this total. We also added about 360,000 other devices, primarily home phone connect.

The offset to these additions was the net change in basic phones. Total phone net adds were 1.9 million for the year, representing about 47% of the total. We ended the year with 102.8 million total retail connections.

Our industry-leading postpaid connections base reached 96.8 million and prepaid totaled 6 million. Postpaid gross adds increased sequentially to \$4.3 million and totaled \$15.1 million for the full year, up 1.7%. Roughly 60% of our gross adds for the quarter and the full year were smartphones.

Our postpaid upgrade rate was 7.4% in the fourth quarter and our quarterly average was 7% for the year. As you would expect, a significant percentage of our upgrades are smartphones, which benefits us from a service revenue perspective. About 23% of upgrades in the quarter were basic phone customers getting a smartphone for the first time. A majority of the remaining upgrades were 3G smartphone customers moving up to a 4G smartphone, which we are able to monetize through higher data usage and lower cost to serve.

Our churn metrics continue to be market leading. Our retail postpaid churn was 0.96% in the fourth quarter, down 1 basis point sequentially and up 1 basis point year over year.

Next let's turn to slide 10 and take a look at device sales and our progress on 4G LTE. Postpaid device activations, which include both gross adds and upgrades, totaled 11.5 million in the quarter. This is higher than any prior quarter in 2013. For the full year total postpaid activations totaled 41.5 million.

Smartphone activations totaled 8.8 million in the quarter and 87% were 4G LTE. For the year, smartphone activations increased 7.8% to 31.1 million.

Smartphone penetration increased to 70% of total phones. About 58% of our smartphones are 4G. We still have approximately 25.5 million basic phones and 24.7 million 3G smartphones in our customer base, which gives us plenty of opportunity in 2014.

We had our best quarter of tablet activations since they were first introduced in late 2010. We activated about 790,000 postpaid tablets in the quarter and 1.9 million for the full year. Our tablet base now stands at 3.6 million, so again we have a great opportunity in 2014 to expand this category and generate growth.

4G device penetration within our postpaid base really picked up in 2013. At year-end 44% of our retail postpaid connections were 4G, up from 23% one year ago.

Usage on our network continues to rise. Currently about 69% of our total data traffic is carried on the 4G LTE network. Going forward, we will continue to add capacity and optimize our 4G LTE network, ensuring that customers are receiving the quality and consistent reliability that they expect from our network and devices.

Let's move next to our Wireline segment starting on slide 11.

Our Wireline investments in platforms such as FiOS, global IP, security, cloud services, and machine to machine enable us to deliver the services, applications, and solutions that our customers want. As these services scale, they will become increasingly efficient and will improve our overall cost structure.

In the consumer and mass markets business, we continue to see positive revenue trends. For the last six quarters consumer revenues have grown in excess of 4%. In the fourth quarter these revenues were up 6.4%, driven by FiOS price increases and incremental revenue from FiOS Quantum.

We believe that consumer revenue growth in excess of 4% in 2014 is sustainable. FiOS now represents about 73% of consumer revenue and we sustained strong double-digit growth throughout the year. FiOS consumer revenue grew 14.9% in the fourth quarter and 14.3% for the full year.

Within our base 46% of our FiOS Internet customers subscribe to Quantum with speeds ranging from 50 to 500 megabits per second. In the fourth quarter 55% of our FiOS Internet sales were at speeds in excess of 50 megabits per second.

Our overall consumer monthly ARPU increased to \$117, up 10.8%. Roughly two-thirds of our FiOS customers are triple play, which have a much higher amount of recurring revenue per month.

In terms of adding new customers, we are focused on profitable growth and have been disciplined in our approach in this very competitive market. In broadband, we had 126,000 new FiOS Internet additions in the fourth quarter and now have 6.1 million subscribers representing 39.5% penetration. Overall, net broadband subscribers were a positive 20,000.

In FiOS video we added 92,000 new subscribers in the quarter. Total FiOS videos customers reached 5.3 million, representing 35% penetration.

We also continue to make steady progress with copper migrations. During the fourth quarter we converted about 80,000 customers. For the full year we converted 330,000 customers, exceeding our target of 300,000.

This network initiative is important for us as we systematically reduce our dependence on older technologies. At the end of the year less than 1 million consumer customers remain on copper services within our FiOS footprint.

Aside from the maintenance savings and improvements in customer satisfaction, conversions to fiber also provide customers the opportunity to purchase FiOS services which would result in additional recurring revenue. Looking at access lines, retail residential connections declined by 5.2% compared with a loss of 6.2% at this time last year.

Let's move to our enterprise markets next on slide 12.

In the fourth quarter global enterprise revenue declined \$200 million or 5.2%. Legacy CPE sales were down 25%. Excluding the quarterly decline in CPE, global enterprise revenue is down 2.6%.

We also continue to see pressure in revenue from the public sector which declined at a double-digit rate. This decline included both soft demand and product rationalization at the federal, state, and local levels. Strategic services, which now comprise 59% of enterprise revenue, grew 2.3%. Key areas of investment such as data centers, cloud, and security services are growing at higher rates.

We continue to work through economic challenges in the enterprise space. In addition to public sector pressures, in the private sector many enterprise customers are more focused on improving their cost structure which puts pressure on our top-line revenue. In general, enterprise customers continue to be cautious regarding new investment decisions.

Moving next to global wholesale, quarterly revenues declined \$138 million or 7.8%. The revenue pressure is caused by the continued decline in legacy transport services. As we have stated, our wholesale strategy is to better monetize our global IP and fiber network by driving a more efficient migration to next-generation Ethernet services.

In terms of profitability, while growth in enterprise strategic services is improving the revenue mix, volume declines and rest of global enterprise and wholesale continue to put pressure on Wireline margins. Through our Verizon Lean Six Sigma program we are making good progress in our cost restructuring programs and retooling efforts, which we believe will ultimately improve our operating efficiency.

Let's turn now to slide 13. To summarize our overall Wireline results, total operating revenues were down 1.5% in the fourth quarter and 1.4% for the full year. FiOS and certain strategic services continued their positive growth trends, while global enterprise and wholesale were pressured by declines in legacy transport services, CPE, and challenges in the public sector.

In terms of Wireline profitability, fourth-quarter EBITDA was \$2.2 billion, resulting in an EBITDA margin of 22.4%. For the full year, EBITDA increased 2.5% to \$8.7 billion with an EBITDA margin of 22.2%. As expected, our margin is similar to 2012. As I have stated in the past, we are confident that we will increase our Wireline EBITDA margin in 2014.

Let's turn to slide 14 for a discussion of our cash flow results. Our cash generation in the quarter remained very strong. For the full year, cash flows from operations increased to \$38.8 billion, an increase of more than 23%. Free cash flow increased to \$22.2 billion, up 45%.

Capital expenditures for the quarter totaled \$4.8 billion and were \$16.6 billion for the full year, an increase of 2.7%. We continue to be very focused on improving investment returns and capital efficiency, and our annual CapEx-to-revenue ratio improved from 14% in 2012 to 13.8% in 2013.

At the segment level, Wireless capital spending was \$2.7 billion in the fourth quarter and \$9.4 billion for the full year, up 6.4%. In Wireline capital expenditures were \$1.8 billion in the quarter and \$6.2 billion for the year, down 1.8% from 2012.

The strength of our financial position enabled us to raise a record-setting amount of capital in the debt markets last September. We ended the year with total debt of \$93.6 billion with all the permanent financing in place related to the pending Vodafone transaction.

We have a positive track record in terms of deleveraging the balance sheet. Our pre-transaction leverage ratios were very low and we utilized cash to retire \$8.1 billion in bonds during 2013. Even though we have more debt, our balance sheet remains strong and we retain the financial flexibility needed to grow the business.

In 2014, our priorities for uses of cash are unchanged. We will continue to invest in our networks, purchase spectrum, and delever the balance sheet in a prudent and disciplined manner. We do not need to execute any major acquisitions to drive our business model. We understand the importance of our dividend and our Board of Directors has shown it support by approving dividend increases in each of the last seven years.

In terms of capital spending, we estimate total spending in 2014 to be in the range of \$16.5 billion to \$17 billion with continued improvement in our annual CapEx-to-revenue ratio. We will be opportunistic in terms of acquiring new spectrum and have consistently demonstrated our ability to execute on this through a number of secondary market transactions. Our willingness to sell or swap lower band spectrum with competitors' shows our industry leadership and strong belief that spectrum should be in the hands of companies that plan to deploy the spectrum and put it to use.

As far as pension funding requirements, our minimum required funding for 2014 is \$1.2 billion based on our current plan assumptions. As far as additional forward-looking information for 2014, we intend to provide that on our first-quarter earnings conference call in April. Let's move next to our summary slide.

We enter 2014 with confidence in our ability to take advantage of the growth opportunities in our key strategic markets. We will continue to invest in our networks as the platforms for future growth and innovation. We have strong momentum in Wireless and we expect to build on that strength, driving further penetration of devices and extending our leadership position in 4G LTE.

In FiOS, we expect to drive higher penetration in existing markets and continue to differentiate ourselves with our FiOS quantum product and quality of our video services. In the enterprise space, we will continue to aggressively market key platforms like cloud, security, machine to machine, and video delivery demonstrating to customers that we have a unique set of capabilities to provide customer solutions in a rapidly changing, mobile-first environment.

In terms of our cost structure, we will continue to drive productivity improvements and operating efficiencies throughout the entire business utilizing our Verizon Lean Six Sigma principles.

At the end of the day, it is all about execution. 2013 was a great year. Our focus on the customer and improving the value proposition drove consistent top-line performance and resulted in significant growth in profitability and cash flows, improving our investment returns. For 2014 Lowell and I have challenged our business leaders to build on the strong foundation we have, accelerate the momentum we have achieved, improve the returns on our investments, and create more shareholder value.

We look forward to another great year in 2014. With that I will turn the call back to Mike so we can get to your questions.

Michael Stefanski - *Verizon Communications Inc. - SVP, IR*

Fran, thank you. Evan, we are now ready for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Good morning, guys. Wireless margins were better than we thought; it looks like partially due to the lower upgrade rate. Is Edge putting pressure on the number of upgrades and do you expect the number to be lower in 2014 than it was in 2013?

Then, secondly, T-Mobile's new strategy with ETFs has been getting a lot of attention; how do you see that? Is that sort of an incremental change or do you think it's more of a fundamental change to the industry? And how do you expect that to affect your business as you look out in 2014?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Good morning. On the upgrade side, obviously the volume of upgrades this year were less than last year given all of the policy changes that we made. And also keep in mind that at the end of 2012 we also had a free iPhone for the first time on our network, so that drove a lot of upgrade activity year over year so we had less volume this year.

As far as the Edge program, the Edge program is going very well for us but I would tell you, just to give you a sense, it is generating less than 1% of our profitability right now. So this is not a significant portion of our portfolio. But, obviously, given the competitive environment here -- first off let me just reiterate the fact that I know there has been a lot of questions around a price war. If you really look at what is going on, really what the shift of pricing is between service and equipment and really when you do the math there really isn't much of a price decrease here. It is just a shift of how this market is into the consumer market.

So obviously Edge is important to us from a competitive standpoint, but I'm not going to give guidance, John, on where our upgrade rate will be in 2014. As I said, I will give more guidance here once we close the Vodafone transaction. We have a shareholder vote here in a week, so I think it would put us in a very peculiar situation to give further guidance at this point in time.

I will give more guidance on that at the end of the first quarter. So that is where we stand.

John Hodulik - *UBS - Analyst*

Great, thanks.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst

I guess two. One, can you help us think about Wireline margins next year? How do you think about the issues of total revenue being sort of flat to down and mix issues versus cost cutting? Just trying to scale the potential for Wireline margin growth.

Then second on the OnCue platform, can you give us some more color? Do you envision a full MSO over Wireless or out of region eventually, or is this more of an in-region and sort of ancillary product? Thank you.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Thanks, Phil. Good morning. So on Wireline margin, look, I think that I have been pretty clear on this. Coming into this year I said we would be flat given a lot of headwinds that we have from some of these startup products we have, especially around the Redbox joint venture, VDMS, and some other things in there. So, look, we are very optimistic that we can improve this margin in 2014.

As far as top line, what I gave here today is we are very confident that we can sustain the 4%-plus top-line growth on the Wireline consumer piece of this. And as you notice, we did our price ups here in the fourth quarter of this year, which is different than what we have done in the past, and that was to prepare us for obviously the January 1 witching hour which is when content costs go up in all of our contractual arrangements.

So we have put ourselves in a position this year to offset that content increase which we weren't in a position last year, so we have done some strategic things from a top-line perspective. Obviously, enterprise continues to be a pressure point and I would say that we don't plan for that to change in 2014. And I have said that coming into 2013 and leaving 2013 that I don't think we are going to see much of a change in our enterprise top-line position in 2014.

So I think that the cost-cutting measures of Verizon Lean Six Sigma, some of the improvement in some of these other ancillary platforms where obviously we acquired Hughes Telematics. That is now growing top-line revenue coming into the fourth quarter of this year.

You probably saw today we just signed another agreement with Hyundai to acquire their business. This is a growing platform, but it does put pressure on us because we are hiring people and it was a loss when we acquired it and continued to be a loss through 2013. I think that could change some in 2014.

So there is a number of things here. And I guess what I would say is I am confident that we can improve the margin of our Wireline business going into 2014.

As far as the OnCue acquisition, look, the focus here is really to accelerate the availability of the next-generation IP video service which we will integrate into the FiOS video service. And really what we are trying to do is differentiate this even more so with fiber to the home versus others with the TV offerings and reducing the deployment costs. And this really accelerates us from if we were trying to build IP TV versus buying the IP TV technology.

From an FiOS customer perspective, we expect the benefits that they will have more elegant search and discovery activity and cost stream ease of use. But also keep in mind, with the acquisition of Verizon Wireless and becoming 100% ownership of that we also plan to take that platform and integrate it more deeply with our Verizon Wireless 4G LTE network. So that really was the strategy behind this.

As far as would we enable this platform to take us over the top, obviously we have our video digital media services that we have been working on for 2.5 years. We've just made two acquisitions related to that platform. So, look, we are positioning ourselves strategically to be in a position to competitively compete around the whole mobile first world and video, so I think that is where we are.

Phil Cusick - JPMorgan - Analyst

Thanks, Fran.

Operator

Michael Rollins, Citi Investment Research.

Michael Rollins - Citigroup - Analyst

Thanks. Just a couple questions. First, Fran, if we can just get an update on net debt at Verizon Wireless. And then, secondly, can you talk about the total amount of cost cutting that the Verizon Wireless business achieved during 2013 that contributed to the margin expansion you flagged in the past of the different initiatives that you were working on.

I was also wondering if you could share your aspirations in terms of the cost-cutting potential for 2014. Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

So I guess this will be the last and final quarter that I ever have to do this hopefully. Gross debt of \$5.3 billion, cash of \$3.6 billion, and net debt of \$1.7 billion.

Michael Rollins - Citigroup - Analyst

Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

As far as the cost-cutting side goes, look, coming into 2013 we said that Verizon Wireless had already cut about \$5 billion worth of cost out of their infrastructure. We said that we are targeting them for another \$2 billion in 2013. They actually exceeded that benchmark in 2013.

And, again, I am going to hold on 2014 here and I will give you more guidance when we get to the end of the first quarter. And, again, it is all around our shareholder vote and the acquisition of the Vodafone transaction.

Michael Rollins - Citigroup - Analyst

If I could then just follow up with a different question then. On the pension side you mention the cash investment that you are planning to make for 2014; where are you starting off the year in terms of the funding status? And then where would that \$1.2 billion roughly get you to?

Fran Shammo - Verizon Communications Inc. - EVP & CFO

With the change in the discount rate and our assumptions around the return on assets, our actual unfunded liability from the end of last year to the end of this year has improved by \$2.6 billion, so our unfunded liability at the end of the year for pension is at \$5.9 billion. Now that also is very helpful from us on the annuitization that we also did there during the year of 2013. So puts us in a very good position with the \$1.2 billion minimum contribution that we have into the plan to really start to make this a 100% funded plan.

On the OPEB side of the house, our unfunded liability went from \$24 billion at the end of 2012 to \$19 billion, so a \$4.2 billion improvement on that unfunded liability. So when you look at our balance sheet, even with the \$8.1 billion of bonds that I paid off, we also had a decrease of over \$6 billion in our unfunded liabilities. The strength of our balance sheet has really taken off this year with almost \$14 billion of a decline in our liability.

Michael Rollins - Citigroup - Analyst

Thank you.

Operator

Brett Feldman, Deutsche Bank.

Brett Feldman - Deutsche Bank - Analyst

Thanks for taking the question. Since we have seen some changes in competitive behavior I feel like we've been getting sort of scattered data points around who is taking share from who. In the past, you guys have always had pretty positive porting ratios versus all of your peers. I know you don't give that on a regular basis.

I am just curious; can you either qualitatively or even quantitatively talk about how you feel about your net share gains versus your peers in light of the current environment.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

I think the fourth quarter will stand on its own at 1.7 million adds and 824,000 net phone adds with the best quarter we have had since we launched tablets of 625,000. And I think that in a combination of itself will standalone, but let's just go back here a second from a competitive environment standpoint. I have said before we will compete and respond accordingly where we need to.

If you recall, coming out of the third quarter this question came up and I said, look, we are seeing a segment of our base that is responding to some of the competitive offers and we will make the necessary changes that we need to to compete against those changes. If you look at our churn in the fourth quarter, which was unusual because in a seasonal season we normally would go up in churn from the third quarter to the fourth quarter and this year we sequentially declines by 1 basis point. So I think that tells you that we responded to our base, we listened to our customers, and this is what we do.

Now the competitive environment has changed again here in the fourth quarter and you can expect us to respond accordingly.

The other thing I would hedge ourselves on that we have built our brand very long term and we have built loyalty with our customers. They come to us because of our network quality and superiority. We have -- if you look at the coverage of our LTE network compared to our competitors, we are by far multiple times more coverage than our competitors and some as much as 5 and 6 times more coverage than our competitors.

If you look at our Share Everything Plans, we continue to change them. We launched a new price plan you probably picked up yesterday to go after our basic phone customers and, look, we are going to compete in all devices in all markets.

I think that another competitive advantage we have is our customer service and the quality of that customer service. If you look at the new store we launched, which we call our destination store in Minneapolis, I mean we are going after smartphone customers but it goes well beyond that from a competitive standpoint. I mean if you look at that store, we now are going after the sports and fitness with all kinds of devices, music, gamers. We have a whole home section and, of course, we have been talking about the machine to machine and tablets for a while now.

Again, I think there is more competitiveness than just one little price plan. We will respond accordingly and aggressively and continue to do what we are doing.

Brett Feldman - Deutsche Bank - Analyst

Great. Thanks for that color.

Operator

David Barden, Bank of America.

David Barden - BofA Merrill Lynch - Analyst

Good morning. Thanks for taking the questions. Just first one, Fran, on FiOS. The quarter was a little soft relative to the trend, but what I noticed was that the footprint path is inching towards about 19 million. The homes marketed to looks like it is more in the mid-15 millions.

Could you talk a little bit about kind of the plans for mining out the rest of the FiOS opportunity and how that might contribute to the expectations for healthy consumer growth? I guess that is number one.

Number two, if I could just follow up on something you guys talked about on the Verizon Vodafone transaction. I think, Fran, you had some estimates about what you thought the flowback was going to be and how it was going to impact trading in your stock. And, obviously, I'm sure there has been a lot of hedging of things that have moved around. If you could maybe give us a little bit of an update on what you think the movement around the stock is going to be around the transaction based on your latest data it would be super helpful. Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

So on FiOS, yes, so let's put it in perspective. We came out of the third quarter with an extremely good quarter of growth and the environment became extremely competitive and the competition went after price and dropped pricing accordingly. And we were pretty cautious on how we responded to that.

We didn't believe that we wanted to chase some of those price points in the fourth quarter, because we know from our customer experience that a lot of customers do not want us intruding in their houses during the holiday season. So we were cautious on how we responded to that and obviously that led to some slower growth that we have from a net add perspective.

But here is what I would say: if you look at what we have done in 2013 and the concentration of the copper to fiber migration, which we believe is a more profitable customer at the end of the day, they are just voice and DSL customers. So if you look at our Internet volumes, we actually did over 42,000 more net adds in 2013 with Internet on FiOS than we did in 2012. So that really was the concentration and we exceeded that by 30,000. So we came into the year thinking we would get 300,000 and we did 330,000.

What we are seeing from this base is once we move them with the same price plans, either by voice or DSL, they are then buying up -- if they are only voice, they are coming over to our FiOS Quantum offer. And if they come over, they are buying up FiOS Quantum pretty significantly, which is generating ARPUs in the range of \$15 to \$20 over and above what they were as a copper customer.

And as you know, we gave a disclosure of 55% of these folks are coming in at 50 megabits and above and we will continue to increase our speeds. We are working on a new router that is going to give better in-home performance with all the extra Wireless devices that are going on.

So when you think about profitability and top-line growth, FiOS Quantum is extremely important because when you look at broadband versus TV, look, you don't have the content so broadband is actually more profitable than the TV product. Now having said that, as I said in the third quarter, there is a lag once we move these people in marketing to them and getting to move to the TV. So TV did lag this quarter and I expected it to lag this quarter and I expect it to lag as we continue to migrate this extra less than 1 million homes that we have left in our FiOS footprint.

But I also want to be clear that we are not going to build beyond what our current LFAs are, and as you said, we have 18.5 million homes passed now with about 15.3 million open for sale in Internet and about 15 million for TV. So we have plenty of opportunity here.

But I would also tell you that, again, even with the slower growth of the fourth quarter, we still took market share and still continue to increase our penetration. And New York continues to be our fastest growing market with the most penetration this year over any other market we had in the TV arena. So I think that is what sets us up for 2014. We will continue to execute on the same things that we have done this year, which is concentration on migration and getting those quality customers to buy up in their bundles.

On the second question of flowback, look, I think it is getting harder and harder for me to do zero in on what the flowback is given what the market has done and the short positions and everybody positioning where they are. As we said when we came into this transaction, we thought the net flowback would be around 300 million shares, but keep in mind we will have somewhere between 4.1 billion and 4.2 billion shares outstanding. So it is a pretty insignificant, minimal amount based on the volume of daily trading that we think we will have.

That is really all the thought I can give you on the flowback at this point in time.

David Barden - BofA Merrill Lynch - Analyst

All right. Thanks, guys.

Operator

Mike McCormack, Jefferies.

Mike McCormack - Jefferies & Company - Analyst

Thanks. Fran, maybe a couple of things. You commented regarding the Edge program; it seems like some of the competitors out there are moving to EIP which you can argue is a pretty bad deal for the consumer but pretty good for carriers. Why wouldn't you guys just get more active in the Edge marketplace and offload that subsidy back to the consumer?

And then, secondly, on the enterprise side it seems like the industry overall has been pretty weak. Can you just comment like the different pushback pieces there between legacy to new migration; what does the pricing environment look like? And then from a competitive standpoint are you seeing any change there? Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Look, on the Edge program, I mean as I said earlier, we will respond where we think we need to respond. I'm not going to get into what others have done between Edge and subsidy. We had a very successful fourth quarter and what we launched to the marketplace they were receptive to that. We ran a lot of promotions in the fourth quarter and it drove a lot of growth to our business.

Again, we will continue to do what we do best, which is we add customers and we are profitable.

On the enterprise side of the house, look, this is becoming a more and more struggling event here given the uncertainty of the government. As you know, what causes more concern now is that the president has nominated Senator Baucus, who was leading the Tax Reform Act. He has now been nominated to ambassador of China, which means now that could delay some reform. Now others are picking it up.

But this just gives more room for caution as to what is going to happen in 2014. Are we going to get tax reform? What about the extenders? They haven't talked about extenders at all. There is a large cliff that we hit here on December 31 which was we lost a lot of credits and obviously the accelerated depreciation deduction is gone.

So there is a lot of things that are putting enterprise back on their heels and people are just looking for cost-cutting measures, which means that means I take a top-line decrease in order to maintain that business.

From a public sector perspective, look, the federal government, our sector there, is declining double digits year over year and that is obviously putting a lot of pressure here. There are opportunities in that segment that we are exploring, but the way I would look at this is you have seen us make some moves here around EdgeCast, upLynk, and video digital media services. And you have seen us make some other moves in our cloud and what we have recently launched with our new cloud product in a beta test.

So within security, cloud data centers, and advanced communications arena we are growing revenue year over year, even more significantly than strategic services overall. So there are certain niches that are growing, but unfortunately it is not enough to offset the other declines that we are seeing just from the public sector and some of these other pressures that we are getting from the large enterprise customers.

Again, I think 2014 will be pretty much flat with where 2013 was. I don't expect it to get any worse, but it will be a tough slug for 2014.

Mike McCormack - *Jefferies & Company - Analyst*

Fran, you have talked about in the past I think the percentage of customers -- this goes back many years probably -- but percentage of customers that have already moved from legacy product into IP Ethernet. Is there a metric you can put around that as far as the customer base goes?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

You know, Mike, to be honest I don't know that off the top of my head. I'm sorry.

Mike McCormack - *Jefferies & Company - Analyst*

Okay. Thank you.

Operator

John Mark Warren, Morgan Stanley.

John Mark Warren - *Morgan Stanley - Analyst*

Thanks. I was just wondering; on FiOS Quantum you have had a lot of success getting customers to upgrade from lower speeds like 10 megabits per second to 50. Is that typically a one-time boost or do you see customers continuing to come back for more speed?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

John, thanks for the question. We actually continue to see customers come back. And if you think about this, this is like when you are in your home, if you have one or two wireless devices running off of that Wi-Fi at 10 megabits and you start to put three or four devices on that, guess what, you're not getting 10 megabits to those wireless devices anymore. You're getting something significantly less than that.

So the only way to compensate for that is to increase the speed into that router so we see customers 50, 75, 100. And as I said, we are going to come out with a new proprietary router that is going to even increase the speeds even more that are available for those wireless devices as people start to saturate the inside of their homes with tablets and other machine-to-machine connections. So this is an ongoing upgrade that customers are doing.

We do this very seamlessly within the Verizon FiOS TV product or online, where we pop up things within your TV. You can even just click the okay button if you want to upgrade right there and then and it automatically does it. There is no phone call needed. We make it very easy for customers to do that but, yes, we see customers coming back for a second time.

Operator

Kevin Smithen, Macquarie.

Kevin Smithen - *Macquarie Research Equities - Analyst*

We have started to see a bit of a resurgence in access line M&A activity in the industry. Are there opportunities for Verizon to divest Wireline assets in 2014 or 2015 in order to increase the Wireless mix and deleverage the balance sheet? And if Wireline is a third of revenue today where would you like to see that in three years?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Thanks for the question, Kevin. That is pretty little foresight there on divestitures but, look, I think Lowell and I have always said we will always look at opportunities for anything. If we feel that we can get an adequate return for our shareholders based on the investments we have and the properties we have, then we will execute on that.

So, look, I guess I would say we always have an open mind but at this point there is nothing on the table for us around that. The properties we have are performing extremely well and we will continue to execute on that.

As far as a three-year view, I guess I will talk maybe a little bit more of that when we get to the end of the first quarter call, but again I'm not going to give any more further guidance. Look, I think we are very satisfied with the asset portfolio we have. With the acquisition of Verizon Wireless and owning 100% of that asset, you are going to see us do more things around converged solutions, so the Wireline assets, in my view, will actually become more valuable over the longer term here with our footprint.

So at this point I would say we are open, but nothing on the table at this point in time.

Kevin Smithen - *Macquarie Research Equities - Analyst*

You mentioned the loss of some of the tax credits for bonus depreciation, etc. When you think about your capital budget for the year are you going to continue to spend at the clip you spent last year for Wireless, given some of the spectrum and strong subscriber growth, or are there risks to the CapEx number to fund some of the higher cash taxes that are likely?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

No, because I think -- look, we gave guidance on CapEx at \$16.5 billion to \$17 billion. As I said before, obviously Wireless will take a higher percentage of that CapEx spend and the other areas of the business will take a lower portion of that CapEx spend, especially as the FiOS builds continues to slow here. But, no, there is no strategic change in the way we view our investments.

I don't do investments based on tax law. I didn't accelerate CapEx spending when the accelerated depreciation went into effect. I don't anticipate I am going to slow capital spending because it is not there anymore, so I think we will just continue to drive and execute on what we have.

From a cash tax standpoint, as I said before, obviously our cash taxes will go up with the acquisition of the 45% of Wireless. I have guided for next year when we announced the acquisition that we would be somewhere in 35% to 36% ETR, so I think at this point that is where we will keep it and I will give you more color once we come out of the first quarter.

Kevin Smithen - *Macquarie Research Equities - Analyst*

Thank you.

Operator

Joe Mastrogiovanni, Credit Suisse.

Joe Mastrogiovanni - Credit Suisse - Analyst

Thanks for taking my question. Fran, you have potentially some spectrum opportunities in the secondary market and then you have a couple of spectrum options coming up. How should we think about the way you prioritize the low band spectrum versus maybe the mid and high band spectrum?

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Look, as obviously I think we have shown that we have made the secondary market a very viable market. We have done a number of swaps with Leap/T-Mobile, sales with T-Mobile and AT&T, and some swaps even with AT&T in that piece sale that we did.

As far as our portfolio, obviously we like the 700 megahertz for the coverage of the LTE that we did. AWS is our sweet spot at this point in time, which is the spectrum that we have been swapping for, so we have a very efficient portfolio of spectrum and I think we have shown through the years that we are very efficient on how we use spectrum.

Keep in mind that, as I said, we will participate in the auctions because we will need more spectrum, but right now our current position is that with the AWS that we have and that we are launching in markets that you know in New York and San Francisco, Chicago we are lighting that spectrum up. It is pretty much completed in New York. We will continue to add to that, but keep in mind though too that we will also re-appropriate our 3G spectrum to 4G.

So we will take that PCS spectrum that has been running in our 3G network -- as the volume of that network continues to decrease as we move more 3G phones to 4G, we will bring re-appropriate that spectrum over to the 4G LTE. So three to four years we are in very good shape from a spectrum holding position, but we will participate in the upcoming auctions.

Operator

Jonathan Chaplin, New Street Research.

Jonathan Chaplin - New Street Research - Analyst

Thanks very much. I wonder if I could just follow up on that last question. I think the next block of spectrum that is going to come on to the market as AWS-3. So two questions around that.

First of all, do you see that as a valuable spectrum block that you really [want to be] a part of, or is there enough opportunity within repurposing some of your 3G spectrum to 4G that that is not critical? Then in terms of deploying that spectrum if it is valuable to you, does it require you to put more equipment on the tower, or because it is contiguous to existing spectrum that you are deploying, can you do with all existing equipment? Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Jonathan, on this one, look, we will participate in the auctions that are coming up, whether it is the AWS-3 or if it is the broadcast or whatever the FCC is going to auction here in the future. We have to build our portfolio for the next 10 years out so as we have done in the past and we have shown that when auctions come up it's opportunistic. They only come up one time so you need to participate.

And that is what we showed when we won our 700 megahertz. We won the A and the B blocks a while ago and now we have repositioned that portfolio. We have launched the 700 megahertz and the AWS that we have.

So AWS-3 is pleasing to us. Some of the higher frequencies is pleasing to us. Again, I won't get into -- I am not an engineer, so I'm not quite sure what has to happen within the network in order to enable these spectrums, but don't think it is much based on what we have done with AWS. So we will participate in upcoming auctions.

Jonathan Chaplin - *New Street Research* - Analyst

Great. Thanks very much.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - *Wells Fargo Securities* - Analyst

Great, thanks. Fran, I just wanted to see if you could give us a little -- quantify this, what I call the smart to smartphone device upgrade opportunity. You said you are seeing ARPA lift there, but between the 3G and 4G I know there is more usage. But is there a way to quantify that ARPA lift you have seen with these smart to smart movers?

Fran Shammo - *Verizon Communications Inc.* - EVP & CFO

Look, I'm probably not going to give you that, Jennifer. If you look at a 3G usage moving to a 4G, we know that -- and we have seen it in our base -- as soon as you get on the 4G with video consumption and the quality of video your usage goes up. So obviously it is hard for us to quantify this because with our Share Everything Plan you are obviously buying a bundle of minutes that you can share among all devices.

But as you can see, from our service revenue growth, our ARPA lift, our increase in connections it is all coming together as to how these plans were designed. And as I said, we still have a lot of 3G customers and a lot of basic customers for 2014 that give us a lot of opportunity. So I think I will leave it there and the numbers will speak for itself.

Jennifer Fritzsche - *Wells Fargo Securities* - Analyst

Thanks, Fran.

Michael Stefanski - *Verizon Communications Inc.* - SVP, IR

Thank you for your questions today. Before we end the call I would like to turn it back over to Fran.

Fran Shammo - *Verizon Communications Inc.* - EVP & CFO

Thanks, Mike. Look, our industry has a very healthy competitive environment and we are forecasting continued strong demand for video and broadband across multiple networks.

As I said, Verizon will compete aggressively in all of our markets. We will focus on delivering a superior customer experience on the best networks in the world. Our customer value proposition and the efficiency delivery of our services will generate growth and profitability. This focus on profitable growth will create value for our shareholders, provide the earnings and cash flow necessary to reinvest in our networks and platforms for future growth and innovation.

We are very excited about the future. We will continue to invest, innovate around solutions, deliver for our customers, our shareholders, and our Verizon employees. So again Happy New Year, everyone, and thank you for joining our call this morning.

Operator

Ladies and gentlemen, that does conclude the conference call for today. Thank you for your participation and for using Verizon conference services. You may now disconnect.

Thomson Reuters Editor

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ADDITIONAL INFORMATION AND WHERE TO FIND IT

Verizon Communications Inc. has filed with the SEC a registration statement on Form S-4 containing a prospectus with respect to the Verizon securities to be offered in the proposed transaction with Vodafone (the "prospectus"). Verizon also filed with the SEC a proxy statement with respect to the special meeting of the Verizon shareholders to be held in connection with the proposed transaction (the "proxy statement"). The registration statement on Form S-4 was declared effective by the SEC on December 10, 2013. Verizon mailed the prospectus to certain Vodafone shareholders and the proxy statement to Verizon shareholders on or about December 11, 2013. VODAFONE SHAREHOLDERS ARE URGED TO READ CAREFULLY THE PROSPECTUS AND VERIZON SHAREHOLDERS ARE URGED TO READ CAREFULLY THE PROXY STATEMENT, EACH TOGETHER WITH OTHER RELEVANT DOCUMENTS FILED OR TO BE FILED WITH THE SEC, IN THEIR ENTIRETY BECAUSE THEY CONTAIN OR WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTION AND RELATED MATTERS. Investors and shareholders can obtain free copies of the prospectus, the proxy statement and other documents filed with the SEC by the parties through the website maintained by the SEC at www.sec.gov. In addition, investors and shareholders can obtain free copies of the prospectus, the proxy statement and other documents filed with the SEC by Verizon by contacting Verizon's Assistant Corporate Secretary, Verizon Communications Inc., 140 West Street, 29th Floor, New York, New York 10007. These materials are also available on Verizon's website at www.verizon.com/investor.

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