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VZ - Q3 2017 Verizon Communications Inc Earnings Call

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Co. reported 3Q17 GAAP EPS of \$0.89.



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PRESENTATION

Operator

Good morning and welcome to the Verizon third-quarter 2017 earnings conference call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

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 of IR

Thanks, Eunice. Good morning and welcome to our third-quarter earnings conference call. This is Mike Stefanski and I'm here with Matt Ellis, our Executive Vice President and Chief Financial Officer, and Brady Connor, who will be assuming my role as the head of investor relations later in the fourth quarter.

As a reminder, our earnings release, financial and operating information, and the presentation slides are available on our investor relations website. A replay and transcript of this call will also be made available on our website.

Before I get started, I'd like to draw your attention to our Safe Harbor statement on slide 2. 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 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 included in the financial materials we have posted on our website. The quarterly growth rates disclosed in our presentation slides and during our formal remarks are on a year-over-year basis unless otherwise noted as sequential.

Before Matt goes through the results, I'd like to highlight a few items. For the third quarter of 2017, we reported earnings of \$0.89 per share on a GAAP basis. These reported results include a few special items that I would like to highlight.



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Our reported earnings include a net pre-tax loss of about \$620 million, primarily associated with early debt redemption costs of \$454 million and acquisition- and integration-related charges of \$166 million pertaining to Yahoo and other acquisitions. The net impact of these after tax was approximately \$374 million, or \$0.09 per share.

Excluding the effect of these special items, adjusted earnings per share was \$0.98 in the third quarter compared to \$1.01 a year ago. Included in our EPS is a \$0.01 impact due to the natural disasters in Texas and Florida during the quarter.

With that, I will now turn the call over to Matt.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, Mike. Good morning to everyone on the call. Thank you for joining us today. Let me start by reviewing the progress on our strategic initiatives before getting into detailed results.

The cornerstone of our strategy is to provide our customers with the best network experience available. We are steadily investing to advance our 4G LTE leadership and actively building the network of the future. Our network performance leadership was evidenced by a sweep of third-party surveys for the first half of 2017 and the network's resiliency during the recent hurricanes and wildfires.

We delivered solid operational and financial performance in a competitive environment. We grew our retail postpaid and prepaid wireless bases with new unlimited data options and maintained strong customer retention. Service revenue trajectory also improved as expected.

Our wireline results were consistent with the past quarters, despite ongoing consumer video headwinds throughout the industry. Demand for our high-quality fiber-based products remains strong. Our Oath team's integration of AOL and Yahoo is ahead of our internal expectations.

We are confident in the execution of our strategy to drive profitable growth, generate strong cash flows, and produce long-term value for our shareholders. The Board of Directors demonstrated our commitment to return value to our shareholders when they declared the 11th consecutive annual dividend increase last month.

We will start by reviewing the third-quarter segment operating performance followed by a progress update on our new businesses, a walk-through of consolidated results, and finally network and technology updates.

Now onto the wireless segment on slide 5. Our wireless business delivered another strong quarter of operational performance in a highly competitive environment. We grew and retained high-value postpaid customer relationships profitably.

In August, we expanded our postpaid unlimited data plans to include a lower price access entry point, which provides consumers with more choices to experience the leading 4G LTE network. With confidence in our network, we are now addressing a larger market with unlimited.

Given our clear and comparable service value proposition, momentum continued in the quarter. Smartphone net adds were 486,000 versus 242,000 last year. Total postpaid net additions of 603,000 included phone net adds of 274,000, 91,000 tablets, and 238,000 other connected devices, led by wearables. We added 30,000 postpaid accounts versus a loss of 107,000 last year.

Total retail postpaid churn was 0.97% for the third quarter, which improved by 7 basis points year over year. Postpaid phone churn was 0.75% and was the main driver of the improvement in total postpaid churn. Postpaid device activations were nearly 9.8 million, of which 82% were phones. Our retail postpaid upgrade rate was 5.5%. During the quarter, 6.1 million phones were activated on device payment plans.

Prepaid net adds were 139,000 for the quarter with an increased focus on the smartphone value proposition. Additionally, we've recently expanded our offering to allow families the flexibility to combine different prepaid plans at a great value.



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Let's turn to slide 6 and take a closer look at wireless revenue and profitability. Total wireless operating revenue declined 2.4% in the third quarter as compared to a 3.9% decline a year ago. On a year-over-year basis, service revenue declined 5.1% versus a 6.7% decrease in the previous quarter. Sequentially, service revenue increased for the first time in 12 quarters.

The key drivers of overall improvement in service revenue include increased access revenue through customer migration to higher access points, new account formation, and the tail end of the transition of customers to unsubsidized pricing. We now have approximately 78% of the postpaid phone base on unsubsidized plans as compared to 60% a year ago. We expect the service revenue trend to continue to improve in the fourth quarter and to exit the year with a decline of less than 4% year over year.

In the third quarter, equipment revenue increased 5.5% due to a higher device payment plan take rate. The percentage of phone activations on device payment plans was about 77% in the quarter, which is consistent with the prior period. We expect the take rate for device payment plans for the fourth quarter to increase seasonally due to heightened consumer equipment activity. Approximately 49% of our postpaid phone customers had an outstanding device payment plan balance at the end of the quarter.

Wireless EBITDA margin as a percent of total revenue was 46.2%, up slightly sequentially and up from 44.9% a year ago. In the fourth quarter, we expect the improvement in service revenue to flow through wireless EBITDA margin, partially offsetting pressures from higher seasonal volume, advertising expenses, and promotional activity.

Let's move next to our wireline segment on slide 7. Total reported wireline revenue grew 1.1%, including XO operations and data center divestitures. On an organic basis, wireline segment revenue decreased 2.7%, which was consistent with the prior quarter.

Our fiber offerings continued to gain share and grow revenue, partially offsetting the decline in legacy copper products. Consumer markets revenue increased 0.9%, driven by Fios Internet activity. Consumer Fios revenue grew 4.6%, including the impact of two marquee pay-per-view events during the quarter.

Verizon was recognized by a leading third-party study as the top rated residential Internet provider for customer satisfaction in the Fios footprint. Fios Gigabit Connection, which launched earlier this year, continues to gain traction, offering symmetrical speeds of up to 1 gigabit per second. We added 66,000 Fios Internet customers in the quarter.

Fios Video results were pressured due to the ongoing shift from traditional linear video to over-the-top offerings as well as competitive promotional activity. Fios Video losses were 18,000 in the quarter.

Enterprise solutions revenue, excluding XO, decreased 5.0%, while growth in fiber-based products continues. On a constant currency basis, revenue was down 5.3%.

Partner solutions revenue declined 3.9% on an organic basis, which is an improvement over prior periods. Within business markets, fiber revenue is increasing, driven by demand for Fios broadband products.

On an organic basis, total revenue declined 5.8% year over year. On a comparable basis, the third-quarter wireline EBITDA margin was 21.1% compared to 20.3% a year ago and up 40 basis points sequentially, driven by ongoing cost control measures.

Let's move next to slide 8 to discuss our progress in new businesses, starting with media. During the quarter, our Oath team has been executing on more than 20 integration work streams. We are positioning the business for the future, locking in early synergies and setting out a roadmap for the next several years with expectations to realize \$1 billion in operating expense synergies through 2020.

With the addition of Oath, Verizon's addressable market has expanded from millions of wireless and wireline customers to about 1 billion global content consumers. We are combining the best aspects of AOL and Yahoo to create a uniform and integrated platform to drive engagement and consumer value. Oath revenue was \$2 billion for the quarter. We will provide additional information on Oath in future quarters as we progress through the integration phase.



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Telematics revenue was over \$220 million in the quarter, including Fleetmatics and Telogis. Total IoT revenue on an organic basis increased approximately 13% in the quarter.

Let's move next to slide 9 to wrap up with our consolidated results for the quarter. The solid segment results in the quarter and addition of new businesses drove improvements in the consolidated top-line reported results.

In the third quarter, total operating revenues were higher by 2.5% on a reported basis. On a comparable basis, excluding divestitures and acquisitions, consolidated revenue declined 2.3%. Similar to recent quarters, the primary driver was the year-over-year decrease in wireless service revenue.

On a consolidated basis, excluding special items, adjusted EBITDA margin was 36.7%, up slightly from prior year's margin of 36.5%. We are focused on driving profitability through cost and capital efficiencies across our business. As Lowell announced in September, we have targeted \$10 billion in cumulative cash savings over the next four years.

Let's turn now to cash flows and the balance sheet on slide 10. We had a strong quarter of cash generation supporting our consistent capital allocation program and returning value to shareholders. Year-to-date cash flow from operations was \$17.2 billion, including working capital pressure primarily due to the \$3.7 billion increase of device payment plan receivables.

Year-to-date capital expenditures were \$11.3 billion with a sequential increase for the quarter driven by increased spending in wireless, supporting growing network demand while pre-positioning for 5G. We expect full-year 2017 capital expenditures to be at the lower end of the guided range of \$16.8 billion to \$17.5 billion.

Free cash flow from the first 9 months of the year totaled \$5.9 billion, which included a net after-tax discretionary pension contribution of \$2.1 billion. In addition, our free cash flow does not include proceeds from asset-backed securitizations, which we initiated in the third quarter of last year.

We did not execute an asset-backed securitization during the third quarter, but have generated \$2.9 billion year to date from our ABS borrowings. Over the last few days, we completed our third public ABS transaction this year for \$1.4 billion.

The impact of device payment plans and on-balance-sheet securitization is expected to approach a steady-state by year end, reducing working capital headwinds during 2018. We anticipate working capital fluctuations throughout the year due to seasonality in wireless equipment volumes.

We ended the quarter with \$117.5 billion of total debt, comprised of \$109.6 billion of unsecured debt and \$7.9 billion of on-balance-sheet securitizations. Our near-term unsecured maturities are modest at \$2.3 billion through 2019. Our balance sheet is strong and provides us with the financial flexibility to grow the business.

Let's move next to slide 11 to discuss our network and technology. Our industry-leading wireless and wireline networks are the cornerstone of our strategy. And we consistently invest to ensure that we have capacity to serve growing demand, technology to reduce the cost to serve, and a network position to lead the industry into the future.

We continue to win awards in third-party studies that test a combination of coverage, speed, and reliability. Based on the confidence in our network, we broadened our unlimited options to offer more customers an unmatched unlimited experience on the best wireless network.

As expected, the introduction of unlimited pricing plans has increased the LTE network usage across various busy-hour timeframes and geographies as our customers enjoy the experience of consuming more data throughout the day. We are more effectively utilizing existing network capabilities and service plan features to handle the increased traffic without interrupting the quality of the customer experience.

Just over 50% of our available low- and mid-band spectrum portfolio is being used for 4G LTE. Network reliability and resiliency are critical elements of our wireless network. We are thankful and proud of the work performed by our employees during the tragic natural disasters in Texas, Florida, and Northern California, who ensured that first responders and all of those affected were able to rely on our network in a time of need.



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We maintained a high level of performance through our planning, network redundancy, and rapid response, despite widespread power outages. Although we are not a wireless network operator in Puerto Rico, we have offered assistance to the local carriers and government officials as they work to recover from unprecedented hurricane damage.

We are steadily investing in the network of the future, which we call the Verizon Intelligent Edge Network. This network has many components that lead to a multiuse, software-driven network at scale.

It goes from the wireless or wireline access networks to an intelligent distributed computing platform to a highly automated software-enabled core network. This architecture is enabled by a dense flexible radio network with deep multiuse fiber that we have been building for years.

As we see new use cases, this Intelligent Edge Network architecture will meet the new types of application demand. We will leverage these enhanced network capabilities such as latency, throughput, and security to create network slices that will be tuned to the specific needs of each application.

Our precommercial 5G fixed wireless broadband trials are continuing. Live customer experiences on the network provide key data and learnings that will give us valuable insight for commercial deployments. We are on track to share trial results later in the fourth quarter.

Over the past several years, we have been leading the development of 5G industry standards and the ecosystems for fixed and mobile. Global development is accelerating based on our work alongside industry partners for multiple use cases.

Let's move next to slide 12 to review our strategy for future growth. We are confident in our strategy to drive future growth while delivering near-term results. We are laying the foundation for the network of the future while maintaining a strong lead in 4G LTE coverage, capacity, and reliability.

Our focus is on preserving and growing our customer relationships while expanding our presence in digital media and telematics. The execution model is to deliver strong fundamental results, allocate capital to our networks, maintain a strong balance sheet, and return value to our shareholders.

Our wireless value proposition has evolved to allow more customers to experience unlimited wireless plans on the best US network. We produce solid operational and financial performance across the business in a competitive environment while investing in our best-in-class networks and driving near-term cost efficiencies.

Our long-term strategy is to change people's lives by delivering the promise of the digital world while leading the industry and innovating for future technological applications. 5G provides a path for growth with fixed and mobility use cases with 4G interoperability. The 5G ecosystem is progressing with standards and technology development and we are pre-positioning our network with fiber investments, spectrum resources, and cloud architecture.

With that, I will turn the call back to Mike so that we can get to your questions.

Michael Stefanski - Verizon Communications Inc. - SVP of IR

Thank you, Matt. Eunice, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Simon Flannery, Morgan Stanley.



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Simon Flannery - Morgan Stanley - Analyst

Great, thank you very much. Good morning. Matt, you mentioned the \$10 billion cost reduction program. Could you just give us a little bit more color around some of the buckets on that and how should that layer through the next four years?

And then on unlimited, any updated stats on what percent of your base or what percent of your new customers are taking that plan? And obviously, since you changed it to the two or the three plans, who is taking the lower rate plan versus the higher? Is that splitting more towards the higher ARPU plan? Thanks.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, Simon, and good morning. So on your first question around the \$10 billion, Lowell announced that last month. Since then, we have put a dedicated team against that and we are starting to get around that work. It's a little early to get into some of the specifics of the timing of when you should see that.

But in terms of the bucket that that's going to come across, really think about all parts of the business are in focus here. Whether that is the network, whether that be distribution and care, and even obviously the shared service parts of our business and across the complete supply chain, we are going to take a deep look across the whole business and identify areas where we have the opportunities to significantly improve the efficiency and how we operate the business.

So we will have -- as we get further into that program, we will share more specifics over time, both on where the savings are going to be realized from and also the expected timing. But I think we are off to a good start with it.

In terms of your second question around unlimited and the new price plans, I will tell you that between unlimited and the Verizon 2.0 that we introduced last summer, we now have approximately two-thirds of the base on plans where they can control their overage spend. So that is up, as you would expect, from where we were a quarter ago. And so obviously a significant part of the base now has the ability to do that.

The mix is as expected between the two plans. We are not going to go into the specifics of each of those. I would tell you, though, that in the third quarter, we saw, as we expected, the migration of existing customers from data bucket plans to unlimited plans shifted to where on average they were stepping up in revenue from their bill prior.

And as we expected, we knew initially we would see optimizers who had the opportunity to move to unlimited and save money. We saw that in the first quarter as we introduced those plans.

In the second quarter, we continue to move through that. By the end of the quarter essentially that was flat as customers migrated over. And then in the third quarter we got to the point where the customers migrating over were actually increasing. And you saw the increase in ARPA sequentially from 2Q to 3Q for the first time in three years. So we are seeing good progress there.

Simon Flannery - Morgan Stanley - Analyst

Great. Just one quick follow-up. Any impact then on 2018 or is it really going to be ramping through 2018 so that the impact is more 2019/2020 from the \$10 billion?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

You will see some impact in 2018, but it's a cumulative number over those four years. But absolutely we will see benefit in 2018.



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Operator

John Hodulik, UBS.

John Hodulik - UBS - Analyst

Matt, couple questions on the wireless growth and profitability. First on the upgrades, saw a low number in the third quarter. As you guys look out to the fourth quarter, do you think that changes and maybe bounces back a little bit? Like, maybe you won't see as much seasonality as you typically do? We're basically trying to get a sense for whether it's a lack of change in the technology or just customers at this point waiting for the 10 to come out.

Then related to Simon's questions, you saw sequential growth in service revenue for the first time in a while this quarter. It sounds like those trends are sort of inflecting. Could you guys return to year-over-year growth sooner than the third quarter next year, given those underlying trends you are seeing in ARPU?

And related to your comment about margins, does that mean that we might not see the typical downdraft in margins we typically do in the fourth quarter, given the flowthrough effects that you mentioned?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, John. So as you mentioned, the upgrade rate in the third quarter was a little lower than we've seen in past years. I think what you're seeing there is a difference in timing of some of the new devices coming out versus what we've historically seen.

Obviously Apple is part of that. We are splitting the new devices between the 8, which came out in 3Q, and the X, which comes out in 4Q. But also on the Android OS side of the house, with having the new Google device coming out this month as well, I think you are going to see more of -- we'd expect to see a shift in some of the volumes versus typically from 3Q to 4Q.

So look, as we get into the holiday season, some of those new devices come out, we think we will see strong demand. And look, if you are paying \$1,000 for a new handset, you are going to want that to be on a good network. So we are very confident that we will get more than our fair share of that activity when it comes through in the fourth quarter. But obviously, we will wait to see exactly how that plays out.

In terms of the sequential revenue trends and as you highlighted, we were up in service revenue from 2Q to 3Q. That was in line with our expectations, as we discussed on the last call. As you start to see -- a combination of a number of factors.

We have largely migrated the consumer base to unsubsidized pricing. It was 78% in 3Q, 75% in 2Q. So that transition is largely done and so you are no longer seeing as much of a tail -- sorry, a headwind from the reduction in the line access fee. And as I mentioned, we are starting to see step up in migrators over.

In addition to that, we increased the number of accounts for the second quarter in a row. So you got the total volume in the business up as the rate we are getting from customers going up, too.

So as I said in the script, we expect to be inside a 4% on a year-over-year basis in the fourth quarter. And as I have said previously, I expect that we will get to service revenue growth during 2018.

In terms of your questions about margins, it's a little too soon to say where they will play in the fourth quarter. Obviously, as we are now on unsubsidized, you don't have the same subsidy headwind. But we will see what the environment is like in the fourth quarter competitively and we will respond as necessary. So we will see where that shakes out between now and the end of the year.



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John Hodulik - UBS - Analyst

Great. Thanks, Matt.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - Goldman Sachs - Analyst

Thanks for taking the question. I was hoping you can maybe unpack the improvement you've continued to see in postpaid churn, particularly postpaid phone churn. You obviously have much better visibility into your customer base than we do.

So for example, to what extent do you think that this is a structural improvement in churn as a result of customers moving into unlimited plans and other plans where they can control their overage? To what extent do you think it might just be that the seasonal pattern of device launches has been moved a bit and so we could see it move back to prior levels as we go through that cycle?

And then just as an extension of this question, some of your competitors have been looking to lower churn by including free or deeply discounted streaming video products as part of their bundles. I am curious whether that is something that you think would make sense for Verizon as well? Thanks.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, Brett. Look, I would say as I look at the churn number, we have always had a good churn number. Obviously 0.75% continues the trends that we saw in the second quarter. And really continues the trend since we saw mid-February, when we launched unlimited.

And as we said at the time, the key driver of launching unlimited was to protect our base of customers, which we think is the best, the most valuable set of customers in the industry.

So look, there's a number of things that go into that. But I will tell you one of the biggest pieces is the network experience that Verizon customers have. They get to see that they understand the reality of our network experience versus some of the others and we saw that with some of the recent natural disasters.

So customers on our network understand that when things really matter, Verizon is a network they want to be on. So that continues to be a key part of it. And look, I believe we can continue to have very good churn without necessarily needing to bundle in other aspects into the core offering.

Brett Feldman - Goldman Sachs - Analyst

Is it fair to say that you would expect that on a seasonal basis going forward -- so for example, on this fourth quarter, you still think you might do better than you did a year ago, even if there is an uptick in devices and maybe industry-wide churn?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

You mean do better year over year with respect to the churn number?



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Brett Feldman - *Goldman Sachs - Analyst*

Yes, yes.

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Yes, I think -- look, we've seen that since we launched unlimited and we had a clear and comparable offer in the marketplace. We have demonstrated that our customers prefer being on Verizon rather than moving somewhere else. I have no reason to believe that will change in the fourth quarter as we go forward. So very confident that we will see that trend continue.

Brett Feldman - *Goldman Sachs - Analyst*

Thanks for taking the questions.

Operator

David Barden, Bank of America Merrill Lynch.

David Barden - *BofA Merrill Lynch - Analyst*

Thanks for taking the questions. I guess just a couple. First, Matt, you kind of highlighted the impact of divestitures and acquisitions on the revenue line, which was about a 5% swing versus the reported numbers. Could you maybe walk that down through EBITDA and then to earnings with respect to all the different moving parts year over year?

And then second, Lowell was pretty widely reported as talking about working on a content type of program or partnership or acquisition as you worked into the back part of the year. Could you elaborate a little bit more on what the goal is for that project and maybe how it ties to your plans for launching your own over-the-top video product? Thanks.

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Yes, so I will start with the second one there. So with respect to Lowell's comment around content and a potential deal for usage rights, I would say we are continuing to work that particular transaction.

Lowell, when he made that comment, expected that it would be done by now. Unfortunately, it has taken a little longer to dot the I's and cross the T's. But fully expect to see something there as we move forward.

In terms of the over-the-top, really nothing new to add versus what Lowell said last month. Look, this is a space where we think there's an opportunity for us to play. We think that it makes sense for us to play in that space, but we don't want to launch just a me-too type product.

So we are continuing to look at what makes sense for us to launch something that's differentiated in that space. Probably around live programming. But how and when we launch something will be TBD.

In terms of your questions around the M&A side, obviously at the revenue line, we brought Yahoo in, you brought XO in. And those brought revenue on day one when you've closed the transaction. So same things with the telematics businesses we closed in the back half of last year.

But initially, especially the telematics businesses and Yahoo, not significant at the EBITDA or EPS line. Maybe a little bit of pressure at the EPS line, if anything, about \$0.04 on a year-to-date basis.



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Then they also bring depreciation and amortization, which is why there may not be a huge amount of pressure at the EBITDA line. But as you move down the income statement to operating income and EPS, we see a little pressure this year. As we expand those businesses going forward, we expect them to contribute in the future.

David Barden - *BofA Merrill Lynch - Analyst*

Great. Okay, thanks.

Operator

Mike Rollins, Citigroup.

Mike Rollins - *Citigroup - Analyst*

Thanks for taking the question. Two, if I could. First, I was wondering if you could talk a little bit more about the three- to five-year view for wireless. And just help us understand -- Verizon's expectations with the investments you are making, the technology that you are deploying, how investors should think about top-line growth over a more extended period of time.

Then secondly, if you could delve into a little bit more detail on some of the businesses you've acquired now over the last couple years in terms of both in telematics. And how should investors think about the growth of those businesses over the next couple of years as well, on the top line especially? Thanks.

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Thanks, Mike. So as you think about the wireless business going forward, and obviously I'm not going to talk specifically about our views on 2018 and so on. We will have those discussions when we get to January.

But as you think of the business overall, we are very confident with where you are seeing the growth start to migrate to. We have talked about the trends in service revenue, the fact that we should expect those to get back to positive during 2018 once we've worked through the transition fully from subsidized to unsubsidized pricing.

We think it will continue from there. We will continue to add net adds to the business based off the quality of the network. And then the network will be -- continue to expand the capabilities there as we transition to 5G. And we think that will give us other opportunities to expand the wireless business going forward.

So we are very confident in the future trajectory of the business there. And obviously, as we think about a three- to five-year view, the overall GDP is going to play into that.

But as I think about 5G and what it is going to do for the business going forward, and then as I think about the new businesses coming in and contributing as we expand those, and then continuing to work on the cost side of the business as Lowell described last month, I don't think you are going to recognize the business five years from now versus where it is today.

Mike Rollins - *Citigroup - Analyst*

If I can just follow up on that point. The wireline business is something where you upgrade a significant amount to fiber, but you also have some copper. You are competing for a full triple-play bundle in a lot of your markets, but you are smaller relative to some of your video competitors.



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Have you thought about doing something different in the wireline business in terms of the way the footprint will look? Whether it's through 5G or other investments in the wireline business or other strategic options for that asset?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes, so there's a lot in that question, Mike. So, look, fundamentally as you think about the wireline business, you are thinking about -- there's really two assets there. You've got the legacy copper business, which continues to have secular declines across our set of customers, whether that be consumer, enterprise, small business, whatever.

Then you have the fiber side of that business, where we see continued growth in demand. And that is just not within the ILEC footprint, it's more on a national scale.

So if you think around, we have had the ultra long-haul backbone for a number of years now. Earlier this year, we expand that with the XO acquisition, which added fiber metro rings in 45 of the top 50 markets. We obviously have significant fiber in the Northeast Corridor as we have been building Fios over the last 10 years.

So you should expect to see the fiber side of the wireline business continue to grow and become more relevant. And then as part of that, you've got the convergence of the networks between the fiber network and the wireless network as we densify in 4G and pre-position for 5G. So as we go forward here, we think that the combination of those networks is incredibly important.

Operator

Craig Moffett, MoffettNathanson.

Craig Moffett - MoffettNathanson LLC - Analyst

First, Mike, I just wanted to say congratulations on a terrific career in IR. And thank you on behalf of all of us for all the help you've given us. And Brady, congratulations on your new position as well.

I wanted to ask about consolidation, because it's obviously so topical. And from what Sprint and T-Mobile have said, we could see an announcement as early as next week. Can you talk about how you think a Sprint T-Mobile merger would change the competitive landscape? And would you argue to the FCC and DOJ in favor of approving a transaction like that?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Craig, look, I'll tell you, there is a lot of various rumors and so on around the industry all the time around various M&A activity. And I'm not going to comment on other people's businesses.

I will tell you, we have the right set of assets to compete irrespective of the industry structure. And that's what we are focused on and I'm very confident in our ability to be successful however things play out with other people.

Craig Moffett - MoffettNathanson LLC - Analyst

Thanks. Could I ask -- since there's not much to say on that topic, one separate question there. Could you update us on the 5G fixed wireless broadband trials, what you are seeing? And how that informs your expectations for what you are going to do in 2018?



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Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Absolutely. So we will have more specifics on that later in the quarter and we will get the right folks talking about that. But I can tell you the trials are going very well. And we are getting a lot of good experience using the millimeterwave spectrum and some of the things we are seeing, whether it's the fact that we can deliver service without needing line of sight.

Whether, as I think about MDUs and the number of floors we can deliver service to being more than we expected. We've experienced delivering service in MDUs above 20 floors, which is more than we thought it would be going into the trial.

So a number of good things coming out of the trials. We will get back to all of you later in the quarter with more specific details on the results of the trials and what that means for 2018. But nothing has changed about our intent to launch a fixed wireless broadband offering during the course of 2018.

Operator

Mike McCormack, Jefferies.

Mike McCormack - *Jefferies LLC - Analyst*

Matt, in the prepared remarks, you talk about over-the-top and some of the video pressure that we've all been hearing about a lot more recently. How do you guys look at that? When you look at the customers leaving you, is it leaving just the video piece of it and maintaining the broadband connection? Or are you just seeing a shift to different providers generally?

Then secondly, the spread between those making device payments in wireless versus those that are on unsubsidized plans, how many of those in your best estimate are people that actually were making a payment plan to you guys, paid off the phone, and are opting into sort of a lower price point instead of upgrading the phone?

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Thanks, Mike. So, look, on your first question, there's really nothing new here to us in terms of the trends we've been seeing over the past few years around whether it's cord-cutting or cord-nevers or whatever else.

In fact, we've spoken in the past, two or three years ago we really started speaking about this and the fact that we said the traditional linear TV bundle is not long-term sustainable. And you saw our reaction to that when we launched some of the different plans that we launched at that point in time.

But so we are not surprised by what we've seen around the TV now. But I will tell you what is important. When you move to over-the-top for your video entertainment, the quality of that broadband connection becomes more important than ever.

And if you want a quality broadband connection, Fios and a fiber-to-the-home connection is the best option out there. And we continue to see strong numbers on the broadband side of the business as a result of that. And we are very confident that the Fios Internet offering will continue to be very strong in the marketplace.

As I think about the spread between the unsubsidized and the subsidized payments, look, what you have here is you do have customers who were on subsidized pricing get to the end of their two-year contract. And they then move to unsubsidized pricing and not necessarily getting there through upgrading to a new device and doing that on a device payment plan.



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But that migration, as we say, is largely complete. We now have 78% of the base, which means virtually all of the consumer base is now on unsubsidized pricing. So as we go forward here, that gap between the this year and the last year number will get narrower and narrower. And that's what's going to help drive the service revenue trajectory improvement as we go forward here.

Mike McCormack - *Jefferies LLC - Analyst*

Matt, I'm sorry. Just quickly on the hurricane issue. You guys called out the \$0.01 impact. But anything with respect to volumes in wireless that may have been even better had the hurricanes not hit?

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Certainly we had in both Houston and Florida, we had periods of times when our stores were closed and certainly is an impact. But we also saw good volumes as soon as those stores reopened.

Customers realizing that in times like that, you want to be on the best network. And so we saw an uptick as soon as those stores reopened. And I have to give credit to our teams, whether it be on the network side and all the things they did. And also our teams on the distribution side of the business getting those stores open incredibly quickly after those storms. They did a fantastic job.

Mike McCormack - *Jefferies LLC - Analyst*

Great. And congratulations, Mike and Brady.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - *Wells Fargo Securities, LLC - Analyst*

Great, thank you for taking the question. Matt, if I may, I just wanted to ask on fiber. Because we've all been brought up to believe fiber is really expensive to deploy. And yet we see you coming in at the lower end of your CapEx range.

Not asking you for guidance on 2018, but are you seeing some savings with these XO properties? Are you pulling those laterals yet or is that going to be more of 2018 event?

And then if I also just could ask, the other element of 5G is spectrum. I think Lowell has been on record saying you feel comfortable with spectrum, might not even sit in the next spectrum auction. Could you talk a little bit of how you -- as you look at your inventory, are you feeling comfortable still with what you have? Thanks.

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Yes, I will answer the spectrum question first. We are in -- we believe that we have a great portfolio of spectrum. As you look at the 4G network, only approximately 50%, just over 50% of our spectrum portfolio is serving that network today.

We have got additional spectrum assets that will serve that network in 2018, whether that be re-farming the 850 megahertz and PCS or whether it be putting the AWS-3 to work. Additionally, as you move into a 5G world, we look forward to closing the Straight Path transaction and the XO spectrum transaction as we head into 2018.



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So we are comfortable with our spectrum positions. As we think about future auctions, we will wait to see what is in there and make assessments at that time. But very comfortable with the portfolio we have today.

And obviously as we think about adding capacity to the network, we have more than spectrum as the tools available to us as we go forward. And we have talked about the different technology and architecture tools with LTE Advanced and all the different pieces in there. We continue to be able to add capacity as we move to more software-defined networking and those type of tools.

And then obviously, densification. And that densification is based off having more fiber available in the network. So to get to your first question, we continue to deploy fiber and we will continue to do that as we head into 2018.

As you say, I am not going to talk to 2018 CapEx at this time. But you should expect to see us continue to be deploying fiber around the country as we go forward to service both wireless but also customers across the rest of our businesses and getting into IoT applications as well.

Operator

Amir Rozwadowski, Barclays.

Amir Rozwadowski - Barclays Capital - Analyst

Thanks very much. I was wondering if I could build upon the prior questions around your spending trajectory. If we think about this lower-end CapEx target for the year, how should we consider the outlook against that backdrop of investment?

Clearly, focusing on network quality is a clear focus for you folks. I'm just trying to unpack the commentary a touch, whether it's a shift in some of the spending priorities that's taking place that's enabling you to get to the lower end? Are we seeing inflection with the benefits from software-defined networks flowing through the business at this point? Or anything to that effect, Matt?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Good question. Thank you, Amir. So as I think about the CapEx for the year and where it's coming in towards the lower end of the range, that's still going to be around \$17 billion of spend. So certainly not an insignificant number.

Some of this is just the timing of the activity with the network teams between 2017 and 2018. But look, I'll tell you, the key thing here, and you talk about has there been a shift in priorities, and I would say absolutely not.

The priority to continue to invest in the network, whether that's adding capacity for the networks today or pre-positioning the network and being at the leading edge of building the future network technologies, that priority is unchanged.

And as we head into 2018, you will see that we will continue to spend to continue to do exactly those things. So no major change there. We will -- as we head into 2018, more spending on fiber as we pre-position for 5G and continues to make sure we have the leading network.

Amir Rozwadowski - Barclays Capital - Analyst

Thanks a lot, and one follow-up, if I may. In touching upon that 5G commentary, in recent weeks, we have seen some notable developments around the broader ecosystem, in particular the announcement with Qualcomm to accelerate the global 5G standard in millimeterwave spectrum.

It seems like mobile 5G, in terms of its availability, is now being pulled forward. Is that going to affect the type of services that you plan to offer? Could we see mobile 5G a bit earlier than anticipated here? Any color to that effect would be great.



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Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Yes, I think we were very proud to be part of that announcement with Qualcomm earlier this week. And really what you are seeing there is as we have talked about now for the past two to three years, we said if we put our shoulder behind 5G development, we think we can accelerate versus some of the timing that was taking place.

And in fact, there were some people who were saying they didn't even think 5G was going to be real and if you're going to be able to use millimeterwave spectrum. So we've demonstrated that by our efforts so far.

We've brought the ecosystem together. We've pushed forward the timing of standards coming forward. And not surprised by any of that at all. It's exactly as we expected.

In terms of the timing of mobile 5G, it is certainly not a 2018 activity. But you talk about does it change our view on the types of services we will be able to offer? Absolutely not. We've seen a wide range of services that we will be able to offer on 5G as being why we've been so excited about it, quite frankly. And why we put our shoulder behind getting the ecosystem to move faster on this than they otherwise would have been. And we look forward to being in position to offer those services in the years ahead.

Amir Rozwadowski - *Barclays Capital - Analyst*

Thanks very much for the input.

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

We have time for one last question.

Operator

Tim Horan, Oppenheimer.

Tim Horan - *Oppenheimer & Co. - Analyst*

Thanks, guys. And just to pound the CapEx again. Matt, are you seeing any benefits from the SDN in terms of pricing of equipment? And can you just talk about as you move to 5G, should we think about CapEx stepping up a couple billion dollars a year?

There is a lot of articles in the press over the last couple years that it might cost \$20 billion, \$50 billion to build out a nationwide 5G network. Any color around that would be great.

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Yes, so thanks, Tim. So in terms of benefits from SDN and so on, I mean, sure. As you -- not just SDN, but also network function virtualization, it does allow the value of some of the hardware you put in the network to change over time. And how you operate the network moves more to the underlying software there. So I think we are seeing those trends as we continue to expand the network.

In terms of deployment of 5G, I think some of the people who were estimating those numbers are getting ahead of themselves. And it's just too early to tell. So as we have more visibility into the timing of spend around 5G, we will share that with you. But it's way too early at this point and I'm not going to comment on those estimates.



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Tim Horan - *Oppenheimer & Co. - Analyst*

And then just lastly, on the \$10 billion of expense reduction, how much of that do you think you will reinvest in maybe growth in the business? I guess how should we be thinking about the longer-term margin trend over a three to five-year period?

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Yes, so as you think about that money, really once we generate those savings, it becomes part of the overall pool. But I'm excited about the opportunities that the teams are developing to grow the business going forward.

And it's important that we make sure we have the resources in the business to invest in those things. And we can't be investing in those things if we have inefficiencies in the core business at that point in time.

So we just think it's a responsible thing to do to make sure that we constantly look at the efficiency of the business. And look forward to generating those savings and discussing that more with you in the future.

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

Tim, thank you. And before we end the call, I'd like to turn it back to Matt for a few closing comments.

Matt Ellis - *Verizon Communications Inc. - EVP and CFO*

Thanks, Mike. I'd like to close the call with a few key points. We remain focused on our strategy to invest in our networks while expanding our high-quality customer base and developing new platforms and solutions.

We are well positioned to compete in the current environment while leading the industry into the next generation of technology with our strong network assets. We are confident in our ability to execute our strategy and to generate long-term shareholder value.

Finally, before I close the call today, I want to personally thank Mike for his commitment and the support he has given to me and many others throughout his career at Verizon. And we wish him all the best in the future.

Also, I'd like to welcome Brady Connor to the IR team. I have known Brady for several years and he will be a great successor to Mike in addition to the IR team. Thank you for your time today.

Operator

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



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