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EDITED TRANSCRIPT

VZ - Q2 2018 Verizon Communications Inc Earnings Call

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OVERVIEW:

Co. reported 2Q18 consolidated revenue, excluding certain items, of \$30.2b and GAAP EPS of \$1.00.



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PRESENTATION

Operator

Good morning and welcome to the Verizon second-quarter 2018 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. Brady Connor, Senior Vice President, Investor Relations.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Thanks, Brad. Good morning and welcome to our second-quarter earnings conference call. This is Brady Connor, and I am here with Lowell McAdam, our Chairman and Chief Executive Officer; Hans Vestberg, our incoming Chief Executive Officer; and Matt Ellis, our Chief Financial Officer.

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

Before I get started, I would 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 which 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.



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Before I turn the call over to Lowell for his remarks, let me start with a walkthrough of the second-quarter consolidated earnings on slide 3. For the second quarter of 2018, we reported earnings of \$1 per share on a GAAP basis. These reported results include a few special items that I would like to highlight.

Our reported earnings this quarter include a charge for product realignment of \$658 million, mainly related to the discontinuation of the go90 platform and associated content; severance charges of \$339 million; and acquisition- and integration-related charges of \$120 million, primarily consisting of costs pertaining to Oath. The net impact of these items after tax was approximately \$0.9 billion or \$0.20 per share. Excluding the effect of these special items and the net effects of tax reform and the adoption of the revenue recognition standard, adjusted earnings per share was \$0.99 in the second quarter compared to \$0.96 a year ago. On a comparable basis, adjusted earnings per share before the impacts of tax reform and revenue recognition were up 3.1% year over year.

Let's now turn to slide 4. Consistent with the approach we established last quarter, we have provided a table that illustrates the ongoing effects from the adoption of the revenue recognition standard on our financial results. As a reminder, the adoption of the revenue recognition standard results in a reduction of the wireless service revenue, offset by an increase in wireless equipment revenue, as well as the deferral of commission expense in both our wireless and wireline segments.

The impact from this change has been fairly consistent throughout the first two quarters of 2018. On a year-to-date basis, the cumulative impact of revenue recognition was \$0.14 per share. For the full year we expect the impact to earnings per share to be between \$0.27 and \$0.31. The accretive benefit to operating income in 2018 is expected to moderate in 2019 and then become insignificant in 2020 as the timing impacts to revenue and commission costs converge.

For the remainder of this call, financial results will exclude the impact of this accounting change to provide clear comparability with prior periods, unless otherwise noted. With that, I will now turn the call over to Lowell.

Lowell McAdam - Verizon Communications Inc. - Chairman and CEO

Thank you, Brady; and good morning, everyone. This is the last time I will have to discuss Verizon results with you, so I'd like to take a minute and offer some perspective after serving as Verizon's CEO for the past seven years.

When I first took over from Ivan in 2011, the Company was well positioned for the future. We were leading the charge in the wireless industry by pushing the ecosystem and driving new user experiences with our robust launch of 4G LTE service. We were growing our fiber-to-the-home business, Fios, and expanding penetration in highly competitive markets. The Company had a strong balance sheet and financial profile so that we had the flexibility to execute whatever strategy we chose.

If I look at where we are today, once again the Company is well positioned for the future. Our financial and operating results for the first half of 2018 are strong, as evidenced by our service revenue, earnings, and cash flow growth.

Verizon has 100% ownership of our wireless business and its industry-leading network and customer base. We have driven the 5G ecosystem by pushing the industry to adopt the next generation several years ahead of original expectations, and we are positioned to be the clear leader in the deployment of 5G services based on our technological expertise, asset base, engineering talent, and spectrum portfolio.

This leadership position is attracting opportunities in areas such as over-the-top TV, smart cities, transportation, education, and healthcare, just to name a few. I believe the impact of 5G on consumers will be much bigger than any previous generation, but the biggest impact will be on businesses as we provide the platform for the fourth industrial revolution.

We know the consumer requires a mobile-first digital information experience, and the new businesses that we have added -- such as Oath and our IoT platforms -- are poised to be at the forefront of enhancing our ability to meet this growing customer demand. Our Fios business and our recent One Fiber expansion have proven that fiber-based network solutions will continue to be in high demand and can take significant share in mature markets.



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The cornerstone of our strategy will always be network leadership and customer experience. Verizon has an outstanding leadership team, a unique portfolio of assets, solid financial profile, and a strong balance sheet that enables us to deliver on the promise of the digital world.

I'm also pleased to mention our recently announced tentative agreement with our unions to extend our labor contracts through August 2023. This will give all of our employees the ability to focus on our customers and execute our strategies without disruption. One of my least fond memories as CEO was a strike five days after taking over. I am glad Hans won't share that experience.

What Brady didn't tell you when he started the call this morning is that the four of us are in Houston, Texas. It is an honor for us to be in Houston today to talk about our second-quarter results, spend valuable time with our employees in the area, and celebrate the quality of our customers in this great city. We have an excellent relationship with the city, with Mayor Turner, and with the greater Houston area; and we are very proud of our overall customer experience, network performance, and community involvement -- especially during some of the hardest times, like Hurricane Harvey.

Verizon and the nation's best wireless network work tirelessly to provide customers, loved ones, and first responders with an unparalleled level of reliability and quality when it matters the most. It is with great pleasure that we announce here today Houston as the third of our four initial commercial launch markets for our 5G residential broadband service that will be rolled out later this year.

This is an exciting time for our Company and the industry. I couldn't be more pleased with the progress that Verizon is making, and our recent appointment of Hans Vestberg as CEO solidifies the leadership of this great Company for years to come.

As I have said before, I am confident that Hans is the right person to bring Verizon into its next chapter, and he is the energizing force we need to position Verizon to lead the upcoming fourth Industrial revolution. Matt will now take you through the details of our second-quarter financial results, which highlight the strength of Verizon. Hans will then outline our strategic priorities and talk about the opportunities that lie ahead.

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

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, Lowell, and thank you for the many years of leadership and the support and encouragement you have provided to all of us.

I'd like to start by reviewing the consolidated results on slide 6. Consolidated revenue was \$32.2 billion on a reported basis, including the impacts of revenue recognition. Excluding the impact of Oath and divested businesses, consolidated revenue was \$30.2 billion, an increase of approximately 2.6%.

The wireless business continues to be the primary driver of growth, generating solid service revenue results. On a GAAP-reported basis, we are expecting low to mid-single-digit percentage consolidated revenue growth for the full year. The update to full-year revenue guidance is due to better-than-expected equipment revenue trends.

Excluding special items, second-quarter adjusted EBITDA margin was 35.6%, down from the prior year's margin of 36.5%. Adjusted EBITDA increased \$0.2 billion due to service revenue performance and as we continue to drive operational efficiencies across the business.

Strong revenue momentum and solid margin performance keep us on track to achieve low single-digit percentage growth in adjusted EPS in 2018 before the net impact of tax reform and revenue recognition. We expect the effective tax rate for the full year of 2018 to be at the low end of our guided range of 24% to 26%.

Let's now focus on cash flow results and the balance sheet on slide 7. Our business segments are generating substantial cash flows. During the second quarter of 2018, cash flow from operating activities totaled \$9.8 billion, an increase of \$1.9 billion from the prior year and \$3.1 billion sequentially. This was driven by strong results from the business, benefits from tax reform, and the completion of the transition to on-balance-sheet financing of our device payment plan receivables.



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For the second quarter capital spending was \$3.3 billion, bringing the year-to-date spend to \$7.8 billion. We currently expect capital expenditures for the full year to be closer to the lower end of our guided range of \$17.0 billion to \$17.8 billion, driven by efficiencies from our business excellence initiatives and CapEx management process, as well as the Intelligent Edge Network design. 2018 capital expenditures include deploying 5G for both residential broadband and mobility launches.

Free cash flow totaled \$6.5 billion in the second quarter. We ended the quarter with \$114.6 billion of total debt, which was comprised of \$106.0 billion of unsecured debt and \$8.6 billion of secured debt.

As we stated at the beginning of the year, we intend to use the majority of the benefits from tax reform in 2018 to strengthen the balance sheet. We began to realize these benefits during the second quarter, and our total debt balance declined by \$4.4 billion sequentially.

Our capital allocation methodology remains consistent, focused on having a strong balance sheet with improving credit metrics while continuing to invest in our businesses and returning value to our shareholders.

Now let's move on to reviews of the operating segments, starting with wireless on slide 8. Total wireless operating revenue increased 4.7% to \$22.3 billion in the second quarter. Service revenue continues to generate strong results, producing a 2.5% increase excluding the impact of revenue recognition, driven by customer step-ups to higher access plans and increases in the average connections per account.

Sequentially, service revenue increased by 1.5%. On a reported basis, including the impact from revenue recognition, service revenue increased by 0.8% on a year-over-year basis. Customer migration to unsubsidized pricing continues to approach a steady state, currently at 82% for the quarter as compared to 75% a year ago and 81% in the first quarter.

In the second quarter, equipment revenue increased 6.8%, driven by higher-priced handsets, more than offsetting a reduction in activation volumes. Approximately 49% of our postpaid phone base had an outstanding device payment plan at the end of the quarter, consistent with the prior year.

Our wireless EBITDA was \$10.3 billion in the second quarter, which represents an increase of 5.5%. As a percent of total revenue, EBITDA margin was 46.2%, up from 45.8% a year ago, and was relatively flat on a sequential basis.

Let's now turn to slide 9 and take a closer look at wireless operating metrics. Wireless continues to deliver solid results, driven by the quality of our network experience and strong customer retention. In the second quarter, net phone additions were 199,000, including 398,000 smartphones. Postpaid net adds totaled 531,000, including tablet net losses of 37,000, offset by 369,000 other connected devices, led by wearables.

Our postpaid phone churn of 0.75% is a result of our compelling customer experience on the nation's best network. This represents the fifth consecutive quarter of customer retention at 0.80% or better. Total retail postpaid churn of 0.97% was slightly up compared to 0.94% in the prior year.

In the quarter, postpaid device activations were 4.6% lower than the prior year, of which about 80% were phones. Our retail postpaid upgrade rate was 5.0% as compared to 5.6% a year ago. During the quarter 5.8 million phones were activated on device payment plans.

Prepaid activity in the quarter reflected a total net loss of 236,000 devices compared to 19,000 prepaid net adds in the prior year. 150,000 of the prepaid losses in the quarter were basic phones.

Now let's move to our wireline segment on slide 10. Total operating revenues for the wireline segment decreased 3.4% in the quarter due to ongoing secular pressures from legacy technologies in competition, partially offset by growth from our high-quality fiber-based products. Consumer markets revenue decreased 1.4%, driven by legacy core declines, partially offset by Fios growth. Fios consumer revenue increased by 1.7%, primarily due to our broadband offerings. In Fios we added 43,000 Internet customers and had video losses of 37,000 in the quarter.

Internet ads were driven by strong demand, as customers value their broadband connection more than ever before. Video results continue to face macro pressures from cord cutting.



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Enterprise solutions revenue decreased 4.2% in the quarter, driven by declines in legacy services, partially offset by growth in our fiber-based products. On a constant currency basis, revenue was down 5.1%. Partner solutions revenue declined 2.8%. The increase in customer demand for fiber access is a growth opportunity for this business and is mitigating declines in copper-based products.

Within business markets, revenue decreased 7.4%, mainly due to reductions in CPE sales and ongoing headwinds from legacy services. Fiber-based products continue to grow and are becoming a more significant component of recurring revenue.

Wireline segment EBITDA margin was 19.6%, excluding the impacts of revenue recognition. Price compression on legacy products, secular trends, and increasing content costs continue to pressure wireline margin performance.

Excluding the impact from revenue recognition, we expect margins to be around 20% for the near term. Let's now move on to slide 11 to discuss our media and IoT businesses. During the second quarter the Oath team continued to build out and operationalize its content strategy and make progress towards the integration of ad products into one end-to-end cross-platform and cross-device solution. As we highlighted on our last call, the video platform became integrated in the first quarter.

During the second quarter, half of the demand-side platform for ad inventory was integrated, and Oath is on track to complete integrating the remaining components of the platform within the second half of the year. We expect to see momentum build after advertisers and content owners have the ability to come to us on a single platform. For the second quarter, Oath revenue was \$1.9 billion, which was relatively flat on a sequential basis.

In our telematics business, total Verizon Connect revenue was \$241 million. Total IoT revenue, including Verizon Connect, was up approximately 13%.

Let's now move to slide 12 to summarize our second-quarter results. We delivered another strong quarter of financial results, and our business is well positioned for growth into the future. Consolidated revenue growth was led by wireless service revenue turning positive, inclusive of the headwinds from revenue recognition.

Our unlimited offerings are evolving to provide a new level of flexibility, enabling people to customize their experience on the nation's best network. Churn rates remain low, signaling excellent customer satisfaction and retention of the nation's best wireless customer base.

Last year we announced our goal to drive \$10 billion in cumulative cash savings throughout the business over a four-year period. Our business excellence initiative, which includes a zero-based budgeting, is off to a solid start in 2018. It has yielded approximately \$500 million of cumulative cash savings on a year-to-date basis. Most of the incremental cash savings realized in the second quarter were related to network activities and are reflected in the lower total capital spend. The program remains on track to deliver against our goals over the four-year period.

Adjusted earnings per share for the quarter increased year over year, driven by the strength of our revenue performance and operational efficiencies realized across the business. Finally, we are making significant strides in honoring our commitment to strengthen the balance sheet. We substantially reduced net debt within the quarter, and the business is generating strong cash flows as we prepare for the upcoming launch of 5G.

With that, I will now turn the call over to Hans to discuss our strategic priorities.

Hans Vestberg - Verizon Communications Inc. - Incoming CEO

Thank you, Matt, and good morning, everyone. First let me say that it is a great honor to be named successor to Lowell, and I'm humbled by the opportunity to lead this great Company. I'm looking forward to being part of leading the digitalization era into the most technologically advanced market in the world, which will have significant positive impact on consumers, industries, and our society for decades to come.



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During my tenure with Verizon, I have been actively involved in setting the strategy and priorities for the Company alongside Lowell, the Board, and the rest of the leadership team. We have laser focus on execution of the fundamentals. We are positioning the business for future growth, maintaining a disciplined approach to capital allocation, and driving sustainable financial performance for long-term value creation.

We remain committed to enhancing our network leadership position, strengthening our customer relationships, and driving efficiencies throughout the business. Verizon has assets in place to develop and provide the most advanced next-generation network, which we call the Verizon Intelligent Edge Network. We are positioned for growth in the current generation, and we are leading the way to fully capture the significant opportunity that lies ahead in the transition to the fifth generation of wireless services.

We will continue to be the clear leader in 4G performance, driving further innovation, growth opportunities, and implementing new network capabilities that will further enhance our customers' experience. We have made the strategic investments in millimeterwave spectrum that enable ultra-wide band 5G services. Our fiber deployment is progressing well, with buildouts underway in over 50 markets outside of our ILEC footprint that will allow us to take full advantage of the many use cases that will come to bear in 5G.

Our Intelligent Edge Network design allows us to realize significant efficiencies by utilizing common infrastructure in the core and providing flexibility at the edge of the network to meet customer requirements. Our Oath and IoT assets will provide a platform for us to participate in the use cases that 5G will enable.

We are rapidly approaching the launch of our first use case for 5G with the rollout of residential broadband services. As you know, Sacramento and Los Angeles are two of the four initial commercial launch markets; and you heard Lowell earlier announce Houston a few minutes ago. News and updates on our fourth market will be provided soon.

Residential broadband is just the first of many use cases for 5G that will be deployed on our multiuse network. Progress is well underway across all of the use cases, and we remain focused on providing 5G mobility in 2019.

I'm super excited for the future. We are on the cusp of the fourth industrial revolution, and we have the assets in place to take full advantage of the opportunities that lie ahead.

Now I will turn the call back over to Brady so we can get your questions.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Thank you, Hans. Brad, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Okay, great. Thanks. And Lowell, first I'd like to say congrats on your retirement and your career at Verizon. It's been really -- I've really enjoyed working with you over the years. And also, quickly, for Hans, it will be great working with you as we -- as you take the reins going forward.



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So Lowell, during your tenure as CEO, you've really -- Verizon has really stuck to its core competency of wireless network leadership while other companies have moved to diversify into adjacent areas. How confident are you that this is the right path? And as we look ahead to 5G deployment and adoption, do you believe the Verizon can widen the gap and create a sustainable advantage versus other carriers? Thanks.

Lowell McAdam - *Verizon Communications Inc. - Chairman and CEO*

Well, thanks, John. I think your strategy is based on the assets that you have in your portfolio and where you think you can go with a high degree of success. We talk about competing to win. We don't want to play to play; we want to play to win.

And we've looked at the things that we've done -- network leadership is at the core. It's part of the values of the Company. Every individual here is proud of what we do on network leadership. And we've stayed close to that core. Branching out, though, into things like Verizon Connect and Oath is a very logical, near progression for us. And we see the advantages that will strengthen the core going forward.

If I look at the things that I'm proudest of, it's the things that you mentioned that we've done, and pushing the envelope on 5G and 4G are some of those. I also have to say, a little bit with a smile on my face, I'm glad we didn't follow a lot of the things the analysts and the bankers told us we had to do.

And that has put us in a position now that Matt outlined, where we've got a strong balance sheet; we've got a clear strategy; and I think we are going to put a significant distance between us and the competition. And the first mover on the network generation changes usually gains a significant amount of market share, and with the assets that we have, we think we are in that position with 5G.

John Hodulik - *UBS - Analyst*

Great, thanks, Lowell.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Great, thank you. Good morning. And also I wanted to share my best wishes to Lowell -- good luck with your retirement.

Good to hear the news about Houston. You have talked about a 30 million-plus opportunity for the residential broadband. Can you just help us think about the pacing of that? How are you thinking about the initial timing of the rollout, how many markets we'll see in terms of pops covered over the next 12, 24 months?

And then on the mobility side, you're starting to talk about that a bit more. We have heard some of your competitors talk about how many markets they will launch this year. How rapidly do you think you are going to roll that out? And is that all going to be microwave, or are you going to use some lower bands for the mobility 5G? Thank you. Or millimeterwave.

Hans Vestberg - *Verizon Communications Inc. - Incoming CEO*

Thank you, Simon. This is Hans. So when it comes to the fixed wireless access, as we have said from the beginning, we will have an initial commercial launch of four markets this year. That is going to be based on our sort of software that we developed in the beginning, calling TF.



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We are preparing the whole network with the Intelligent Edge Network to be ready to launch 5G based on the NR standard that is coming out right now, and vendors and equipment manufacturers and OEMs are preparing right now. So we will be ready as soon as that has the maturity to be released to our customers.

So that will come back on -- we will go for the full 30 million households, which is our ambitions that we have explained before. So that's where we are on the fixed wireless access.

On the mobility, we do the same. Remember the Intelligent Edge Network is a multiuse network, so it's the same radio base station that's going to provide our fixed wireless access as mobility. So we are -- and as I said before, we are now in deployment on fiber in more than 50 cities.

So we are preparing everything to be ready for the maturity of the equipment and the softwares, as well as having the CPE and handset market ready for launching those products. And right now that's the ambitions we see in 2019. We have not named the cities, but as you can hear, we are deploying in 50 markets with fiber. So I think that is an important point of it.

So that is where we are. And we will come back and give you updates all the time on the new things we are doing. And today we are now launching the third city here in Houston. We are super excited over that. So we will continue to come with the flow of information what we're doing on 5G.

Simon Flannery - *Morgan Stanley - Analyst*

And when should you launch the first of the Sacramento, LA, Houston? Is that going to be in the third quarter or more likely the fourth?

Hans Vestberg - *Verizon Communications Inc. - Incoming CEO*

Good question. As we say, we say that in the second half of 2018 -- so we promise we will come out and tell you as soon as we know exactly the date.

Simon Flannery - *Morgan Stanley - Analyst*

Thank you.

Operator

Philip Cusick, JPMorgan.

Philip Cusick - *JPMorgan - Analyst*

Thanks again. Lowell, congratulations again; and Hans, congratulations. This should be a lot of fun.

Hans, can you talk us through what's happening on the CapEx side to move toward the lower end of the guide? Are you doing less this year than you expected, or just getting more for it? And where are you in the shift of spending and focus from macro towers to more fiber and small cell? Thanks.



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Hans Vestberg - Verizon Communications Inc. - Incoming CEO

Thank you very much. I think this is a great question. Remember, when I came in, we decided -- together with Matt, Lowell, and the whole management team -- to actually flip the whole network to sort of the horizontal Intelligent Edge Network. And I also explained there were two important factors where we did that.

One, we wanted to deliver a new type of services based on the horizontal network, and especially the ones coming from 5G. And we want to see some of them coming up very shortly. The second was that we also can be so much more efficient with new technologies in multipurpose equipment. At the same time, we put in a new process for capital efficiency that Matt and I are sharing. And I think that's what you are seeing right now.

We are actually doing much more than before when it comes to deployment. And as we say here, we are already deploying 5G things at the moment. We are preparing all the network for it. So that is embedded in the numbers that you see.

At the same time we also are making a big shift in our whole spending. I mean, if I look what we spent in 2017 in the CapEx and in 2018, it's very different. So we are also making shift at all time. But this is nothing that we are limiting. We just are more efficient of using our capital, and my engineering team very happy with the investment that we are doing at the moment.

So I think that we are also -- as you said, we are moving over to much more small cells than making our bigger towers and macrocells. And I will say, if you go back a couple of years ago, our majority of all our investment was on macro towers; and today the majority is on densification with smaller cells.

So we have shift dramatically over the years, and I have only been part of it now for more than one year. But I've seen how the engineering team is responding to the new way of working and setting up the whole new network structure. So, it's -- that's what you see in the figures.

Philip Cusick - JPMorgan - Analyst

If I can follow up: anything you can tell us, given that efficiency about where 2019 CapEx might be upward or downward from 2018? Thank you.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes, good morning, Phil. It's Matt. So I will take that one.

We will stay consistent with what we've done in the past, where we will talk about 2019 when we get closer to it. But I think we've been pretty consistent in our commentary that -- look, we expect CapEx to be reasonably consistent, and as we get closer to 2019, we will provide more color on opportunities to accelerate any spend on 5G as we see it, but it's a little too early in the process to get there yet.

I would just remind you, as Hans said, a lot of the spending that we've been doing around densification supports both 4G and 5G. So the network really is in a great position to be pre-positioned for us moving into 5G here without it requiring a significant step change in total spend.

We have done this before as we move from one generation of technology to another, and keeping total CapEx spend fairly consistent. And we are confident we will do that again.

Philip Cusick - JPMorgan - Analyst

Thanks very much.

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Operator

David Barden, Bank of America.

David Barden - Bank of America - Analyst

Thanks for taking the questions. Thanks again, Lowell, and congrats to you, Hans. Matt, could I just ask a couple questions on the finance side?

Just on the lower tax guide, can you talk about the reasons why that is? And is that flowing through to the cash flow side of the equation, and do we need to address that in the free cash flow number as well?

And then the second one is: could you talk about -- I think as we have done historically -- some of the changes in the union contract forthcoming? How should we think about that impact on the cost structure? I know you gave us about a 20% margin in the wireline side for this year, but is that -- did those negotiations give you some window in potentially having some upside in that margin number in the wireline business? Thanks.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, David. So I will start with the tax question. So as you look at the first half of the year, the ETR was impacted, certainly, by tax reform. But we had a couple of one-timers in there, especially related to the pension contribution we did in first quarter that you wouldn't see necessarily flow through to the second half of the year.

So that's why we are guiding towards the lower end of the 24 to 26 range for the year as a whole. In terms of it flowing through to the cash flow, I would say certainly you should expect cash taxes to be positively impacted this year by tax reform. We didn't have that in the first quarter, because we had no scheduled payments, as you know. Second quarter we had the first of two scheduled payments for the year, and so started to see those flow through. Expect to see lower tax rate flow through to our cash tax payments in the rest of the year.

And that's certainly behind the commentary that we gave around the ability to strengthen the balance sheet this year. So expect to continue to see the benefit from the lower tax rate.

I will let Lowell answer your question around the new union contract.

Lowell McAdam - Verizon Communications Inc. - Chairman and CEO

David, we are really pleased with the relationship that we have built with the union. During the last contract we get together at the senior level very frequently; we've been able to deal with some issues that have been thorns in the side for both the union leadership and members as well as the Company.

So when we decided to attempt to get a contract literally a year ahead of expiration, that was a major change in our relationship. And I would like to thank the union leadership for the way -- the approach that they took during this.

As far as your financial projections, I would say just continue with the projections that you've seen. We do have increases in contributions and that sort of thing, but it's not a significant change to the bottom-line trajectory that you've seen, the way it was after our last contract.

The beauty of all of this is now the management and all of our employees can focus on our customers, and deploying 5G, and deploying fiber. And they can all focus on work and their families and the customer instead of getting ready for a strike. And so we are very, very pleased about this outcome.



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David Barden - *Bank of America - Analyst*

Thanks again, Lowell.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - *Goldman Sachs - Analyst*

Thanks, and I'd also like to extend my congrats to Lowell for a distinguished career, and to Hans for the opportunity that lies ahead.

I was hoping I could ask about postpaid ARPA. That metric has been under pressure for the last several years, although it has shown a lot of stabilization recently. And even though you don't break out phone ARPU intrinsically, we all know that it was phone ARPU that was causing that pressure as subs moved into EIP and, more recently, into the unlimited plans.

It seems like the EIP transition or the unsubsidized transition is fully behind us. I'm not entirely sure where we are in the migration to the new unlimited plan.

So I guess I was just kind of hoping you could talk through the drivers of postpaid ARPA going forward. Do we still have any headwind on the phone side? Is that becoming a tailwind? And then, of course, you've highlighted that you are seeing a lot of other devices, including wearables, coming into your accounts. Are we starting to get to the point where that's becoming a meaningful positive driver on ARPA as well? Thanks.

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

Good morning, Brett. Thanks for the question.

So as you look at ARPA, you are right that the transition to the device payment plans is essentially complete. The year-over-year difference in terms of the percentage of the base on unsubsidized pricing is now in single digits, whereas a year ago it was much more significant. So that shows up in the ARPA.

The other good thing that is in the ARPA, though, is you continue to see the demand for our products and services. So we continued in the quarter to have customers step up in terms of the plans they are on, whether that be from a metered plan to unlimited, or even within our unlimited plans that we offer. And then we continue to see increases in connections per account, whether that be wearables or additional phones on the account.

Those things are coming through to ARPA, and you see the impact there on service revenue overall. So certainly ARPA is stabilizing. And we think as we continue to offer the right plans to customers, and we continue to give them the opportunities to add additional devices to their plans, that it's an area where we can continue to help drive revenue growth going forward.

Brett Feldman - *Goldman Sachs - Analyst*

Have you broken out how many of your customers are on unlimited plan? I apologize if I missed that.



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Matt Ellis - Verizon Communications Inc. - EVP and CFO

We have not. As we said previously, between unlimited and our Verizon 2.0 plans, where customers have the ability to control overage, that had been significantly above 50%. And certainly the number of customers on unlimited continues to grow, but we haven't broken that out at this point. But it's becoming, certainly, a larger and larger percentage of the base.

Brett Feldman - Goldman Sachs - Analyst

Great. Thanks for taking the question.

Operator

Michael Rollins, Citibank.

Michael Rollins - Citibank - Analyst

Hi, thanks, and also wanted to extend my best wishes to Lowell and congrats to Hans.

Just a couple of topics, if I could. First, on the strategic side, as I listened to the management commentary over the past year, is the underlying goal for Verizon to become a leading provider of broadband in the home and on the go across the country? And if this is the direction, how long will this take, and how much can be driven by internal investments versus possible M&A?

And then just one thing on the business trends: postpaid phone growth at the industry level has risen to more than twice the rate of population growth. Do you have any thoughts on what is driving this change and the sustainability for postpaid phones at this new level of growth? Thanks.

Hans Vestberg - Verizon Communications Inc. - Incoming CEO

So maybe I can start with the network question that you have, then, and broadband. I think when I look into the assets we have -- and I've been now working here for quite a while -- I really like the assets we have and the ones we are building.

That will give us the opportunity to be a much larger broadband provider -- and I think the announcement that we did today, that we now are having Houston as well, and we will continue with that communication on the new cities we are going to deploy. And 5G give us that opportunities; but we need to remember when we talk about 5G, 5G is an access technology. There is so much more you need to do to actually have it.

When I look what we are doing all the way from the data center with fiber, unified transport, multiservice routers, the old way I see that this is a big undertaking. But we are in the midst of it, and as I have said a couple of times before, I mean, we have been onto this Intelligent Edge Network right now for quite a while. And we see the benefits and we see the opportunities that it creates.

So you're right; of course, it's going to take time to have it across the country. But as I mentioned, we are already now deploying fiber in 50 cities. So we will come back and give you more color to it, but I think we are preparing the network to be really using the network and leveraging the efficiency in markets. So that's for us a very important piece of it.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

On the postpaid phone, we continue to see consumer demand there. And we believe certainly when we give customers the opportunity to get on the nation's best network and we have the right price plans, we see good things happen there.



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So I can't comment in terms of the industry volumes overall, but we certainly continue to see good consumer demand, and we expect to continue to have postpaid phone net add growth going forward. And we will see how that plays out across the rest of the industry.

But one other comment I'd just add on the network side is in addition to the broadband piece, as we have talked about the strategy, it's once you have that piece, what we -- the services that we can provide above that connectivity layer are also very important as we go forward. And we think we are in a great place to be able to deliver on that too. So hopefully that helps answer your questions, Mike.

Lowell McAdam - Verizon Communications Inc. - Chairman and CEO

Mike, I think I would just add one thing. It's funny; when you are at this point in your career, you get to look back, and you see an awful lot of similar questions, but just asked in a different way. And I remember when we brought Verizon together back in 1999, and we had about 20% market penetration on postpaid; and there was no smartphone; and people were saying, well, where is the industry going? You can't possibly get any more penetration that you've got.

At that point, I pointed to areas like Sweden, Hans's home country, that was at 50% penetration. And we thought, see? We've got all sorts of headroom. And now we are over 100% penetration. And you see wearables, and with 5G -- Hans mentioned this, and I mentioned it in my opening remarks -- you are going to see so much more penetration on all of the different business applications that are going to change people's lives.

So I really don't think much about postpay, or smartphones, or any category you want to look at as an opportunity for future growth. There are so many things that we have literally zero percent penetration in today that are going to be big businesses five years from now.

That is why I am so excited to see the way we are positioned and the leadership team's philosophy around dealing with customer pain points and providing them the products that they are going to need that will be indispensable five years from now. So that's my perspective on that.

Michael Rollins - Citibank - Analyst

Thanks very much.

Operator

Craig Moffett, MoffettNathanson.

Craig Moffett - MoffettNathanson - Analyst

Hi, good morning, and let me join the parade of people saying congratulations to Lowell. Lowell, it really has been a pleasure. And also congratulations to you, Hans. I look forward to your great success.

Let me ask a strategic question about video, if I could. You've discontinued go90 in the quarter. There have at least been press reports about -- at least some discussion about how you move forward with Oath, and whether Oath's addressable advertising might actually be more successful outside the Company instead of inside the Company. I wonder if you could just talk about the role that you see video playing; and now that you've had some time to play around with some of the different strategies around video and addressable advertising? And then, as part of that, if you could specifically comment on the situation in the press reports about Oath, that would be helpful.

Lowell McAdam - Verizon Communications Inc. - Chairman and CEO

Yes, so let me deal with those in reverse order there, Craig, and then I will let Hans come in and put a period on it. The questions around Oath -- I don't know where they are coming from. There's no intention of spinning out Oath in any particular format.



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We see the synergies that we expected to see, and we see the future that we had hoped for. Matt talked about in his remarks the integration efforts that are going on. They are on schedule, and so we see no reason to do that. And there is no credible report out there that -- otherwise, in my view. So I want to be clear about that.

On the video side, look, that is the major driver of traffic that we see on the network today. We only expect that to go up over time. We are not fans of linear, but I'm not trying to criticize anybody else's strategy here. It's just the fact of the assets that we have and the investments that we want to make.

It's much better, in our view, to do digital. So we are, as we have always said, skating to where the puck is going. So that's where we are focused.

I was very heartened by our time in Sun Valley two weeks ago. Hans went, and we met with all of the major content providers -- the sports leagues, healthcare, education, gaming, all of those segments -- and every one of them, when they know what is going on with 5G, and especially the latency, certainly along with the capacity, but when they see the latency, their eyes light up about what's possible.

So my view is -- and I know Hans shares this; we've developed these strategies together. He has always been one of my go-to guys over the last five years to see where the industry is going. But it is our belief that we are positioned perfectly to have the partnerships that we need to be successful. We are not going to be owning content, so we are not going to be competing with other content providers. We are going to be their best partner from a distribution perspective. And I think that makes great sense for the Company going forward.

Hans Vestberg - Verizon Communications Inc. - Incoming CEO

And I can chime in here. I mean, I've been around now for quite a while, both as leading this, but I've been sitting together with Lowell, the management team, and the Board on the strategic decision we have done; and I'm fully on board on all of them.

And when I look at the assets we have, I'm really happy with them, and I'm encouraged to see what we can do with them -- both leverage them and also get more synergies out of all of them. And just talking about Oath, for example, today with the massive competence we have in Oath when it comes to [AI, MM] -- and we are in the transformation of our network to virtualization -- that is a great synergy and creating a lot of new possibilities for us.

On the front end, we are constantly working how we can actually leverage our assets on our -- sort of the Verizon side and the Oath side. And we will continue to find those ways forward.

So I feel good about the assets we have. And I agree with Lowell that we can partner with anyone. And again, we are betting on that we are going to have the best network, the Intelligent Edge Network. We want to have a great 5G, the best; and of course, we can attract partners that we can work with.

And I think that is the model that we have and that we can continue to develop. And I see only opportunities when you go to 5G, when you can both do connectivity platforms and applications, and sort of define where you are going to play in that or where you are going to have partners. So I'm feeling encouraged about the assets we have and what we can do with them.

Craig Moffett - MoffettNathanson - Analyst

Thank you.

Operator

Jennifer Fritzsche, Wells Fargo.



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Jennifer Fritzsche - Wells Fargo - Analyst

Great, thanks. Congratulations to both you gentlemen.

Two, if I may. Can I just explore the wireline CapEx component? It was down about \$500 million from the first quarter, and yet I hear you are doing 50 fiber cities. Can you talk, Matt, maybe about the -- should we begin to see that wireline portion of that CapEx ramp as this fiber build comes together? And then, I guess, what does that mean for what I will call traditional wireless spend?

And then just separately, on millimeterwave spectrum, we do have an auction coming up in November. You guys have a lot of spectrum here. Can you comment on interest, if that might be a part of your focus come the fall?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Thanks, Jennifer. So on the CapEx side, certainly as you look between first and second quarter, you've got timing in there. But as we build out fiber -- and as you say, we mentioned the 50 cities outside of the ILEC footprint where we are deploying fiber today -- you will see a blurring of the line of the CapEx between the segments. Obviously, that fiber build shows up in our wireline segment, but the largest customer for that build is the wireless piece of the business.

So this is part of densifying the network, pre-positioning the network to not just excel in 4G but also be ready for 5G, especially using millimeterwave spectrum, as you mentioned. So I would expect to see a continuation of that spend. But the total CapEx number -- as I said earlier, you should see consistency there.

And what you are seeing is the continued evolution of our CapEx from one generation of technology to the next, and fiber buildout is a key component of that. So you should expect to see a continuation of those trends, and it's part of the Intelligent Edge Network that will deliver 5G. And we are excited about it as we go forward. And I will let Hans talk about millimeterwave.

Hans Vestberg - Verizon Communications Inc. - Incoming CEO

Yes. When we think about data usage of our network, we usually talk in a couple of different ways in order to define what we need. First of all, we have the choice between densifying and deploying on more spectrum. I think that the last round of spectrum we decided to densify, and I think that is now playing out very well for us.

Secondly, looking toward new type of technology and features coming out in the network that can optimize everything from carrier aggregation, etc.; and lastly we are, of course, looking to what spectrum we need to have. That is putting us in in a very disciplined way how we use these three type of assets when we decide what to do in order to have the best return on investment.

Of course, we are looking into any auction that is coming up and seeing how that fits in in that pattern of decision-making with these different type of auctions. So we will look into that. However, we are also feeling pretty good about the position we have on millimeterwave right now. But again, we will look into if there are any holes we need to fill in this process. But again, it will be in that discussion all the way from densification, looking into new features of the technology, and then looking into what spectrum is needed; and then we have the disciplined approach to our return on investment.

Jennifer Fritzsche - Wells Fargo - Analyst

Thank you.



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Operator

Matthew Niknam, Deutsche Bank.

Matthew Niknam - Deutsche Bank - Analyst

Thank you for squeezing me in. Just two, if I could. One on 5G: what are you hearing from your larger commercial and enterprise customers in terms of demand for specific use cases? I'm wondering if that could facilitate any sort of acceleration in your pace of builds heading into next year.

And then secondly, maybe for Matt: on tax reform, you talked about using the benefits this year at least to strengthen the balance sheet. How should we think about optimal leverage for the business today? And how do the uses of excess cash and tax reform benefits -- how do they potentially evolve into 2019? Thanks.

Hans Vestberg - Verizon Communications Inc. - Incoming CEO

Let me start with the 5G and the enterprise. You are right; when we think about the eight different currencies that 5G is going to explore or will have, I think that enterprise is the receiver of many of them when it comes to latency, security, large throughputs, and all of that. We are in constant dialogue with our enterprise customers to see how we can build new type of services for them.

And of course, we are building the Intelligent Edge Network. And here we have the definition at the edge -- how we do a specific slice for an enterprise. And that could be a private 5G network with low latency, or something like that. So we see that as a great opportunity.

There are some features, if I dig a little bit deep on technology, that come out on the next revision of the NR 5G technology, which is on revision 16. That will be even more important for our enterprise customer.

But again, we are building this as we speak. And we have dialogue with all our enterprise customers to see that we are actually innovating together with them new type of services, where you are sort of doing a real-time enterprise based on wireless, which haven't been done before. So I think we are very far on our innovation exploration in this area, and I see great opportunities in it.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes. And Matt, on your question around tax reform, and certainly flowing through the cash flow and the capital allocation, look, the capital allocation -- we've talked about this numerous times, and we are focused on being able to invest in the networks, providing a return to our shareholders. We know the dividend is important. And we've increased the dividend for 11 years in a row now.

And we have also said we want to strengthen the balance sheet and get back to those pre-Vodafone credit rating profile. Certainly tax reform helps accelerate our ability to do that. That's our focus for 2018. You saw good progress in the first half of the year -- not just on the debt paydown, but also, when we say strengthen the balance sheet, we include what we did with the pension contribution as well.

So we're making good progress there. Too early to give specific views on 2019. But certainly, as you know, tax reform will help us get to those leverage profiles quicker than we would have done otherwise. And look forward to updating you on 2019 when we get closer to it.

Matthew Niknam - Deutsche Bank - Analyst

Thank you.



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Operator

Tim Horan, Oppenheimer.

Tim Horan - Oppenheimer - Analyst

Great, guys, and good luck to both of you. Two quick ones.

On Oath, do you still think you are going to be able to use wireless customer data in terms of location and usage to do more targeted advertising? And if so, kind of the timing on that?

And then secondly, it does seem like wireless and wireline networks are converging. Lowell, just curious -- how do the unions kind of feel about this? Do you have the flexibility to really converge these networks in a timely basis? Thank you.

Lowell McAdam - Verizon Communications Inc. - Chairman and CEO

Okay, Tim. Thanks for the question. And I would just say to all of you that asked questions today, thank you for your best wishes.

First, on customer data, our hallmark on this, Tim, is transparency. We don't want to use data unless customers know how we are using it. So far we have been able to do broad data analysis and target our advertising not based on individual customer data, but overall data. I think that anonymous usage we are very clear with customers about. And it's certainly got a lot of value to the Oath assets.

On the convergence side, we are honoring the contract within the footprint. And we are very open with the union about what we are doing, and we are very clear that areas that we manage outside of the union contract will stay clean as we go forward.

So we are -- again, transparency is important to us. We think we can do exactly what we need to do without causing any foot faults, and we are open about it. So we don't view that as a hindrance to our strategy going forward.

Tim Horan - Oppenheimer - Analyst

Thank you.

Brady Connor - Verizon Communications Inc. - SVP of IR

That's all the time we have four questions today. Before we end the call, I'd like to turn it back over to Hans for some closing comments.

Hans Vestberg - Verizon Communications Inc. - Incoming CEO

Thank you, Brady, and I would like to close this call with a few key points as I prepare to start my tenure as the CEO of Verizon.

But I have to start by thanking Lowell for a fantastic journey and fantastic job you have done. And you are going to be here in the transition, and I'm really grateful for that. And just today like this one, we are in the field here in Houston -- meeting employees, investors; we are meeting partners, and of course the city -- I think it shows the relationship we have built over the years. And handing that over to me and the team, I think, is enormous. So I have to chime in to what everybody else has said: it's a fantastic journey you have had, Lowell.



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Coming back to the first half of 2018, we have achieved solid financial and operational performance in a competitive marketplace, and we are pleased where the business is positioned as we start the second half of the year. We remain focused on our core strength of developing superior customer relationships and building the next-generation network for long-term growth.

And I talked about the Intelligent Edge Network, the importance for our business, and I'm pleased to see where we are with that. We are also committed to our strategy and priorities, led by investing in our networks; leveraging the assets across all of Verizon, using platforms such as Oath to further monetize data and video consumption; maintaining a disciplined capital allocation process; and creating value for our customers and shareholders.

We are confident in our ability to execute on our strategy, and we are positioned to take full advantage of the many opportunities that will take shape as we lead the evolution into 5G. As we say at Verizon: we don't wait for the future; we build it. Thank you for your time today.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Thanks, everyone.

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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