

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

VZ - Q1 2015 Verizon Communications Inc Earnings Call

EVENT DATE/TIME: APRIL 21, 2015 / 12:30PM GMT

OVERVIEW:

Co. reported 1Q15 GAAP reported EPS of \$1.02.



CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

Simon Flannery *Morgan Stanley - Analyst*

David Barden *BofA Merrill Lynch - Analyst*

Phil Cusick *JPMorgan - Analyst*

Mike Rollins *Citigroup - Analyst*

Brett Feldman *Goldman Sachs - Analyst*

Mike McCormack *Jefferies LLC - Analyst*

John Hodulik *UBS - Analyst*

Amir Rozwadowski *Barclays Capital - Analyst*

Jennifer Fritzsche *Wells Fargo Securities - Analyst*

Tim Horan *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good morning and welcome to the Verizon first-quarter 2015 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, IR*

Thanks, David. Good morning and welcome to our first-quarter 2015 earnings conference call. This is Mike Stefanski and I'm here with our Chief Financial Officer, Fran Shammo. Thank you for joining us this morning.

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

Before we 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 we have posted to 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 Fran goes through our results, I would like to highlight a few items related to our earnings. GAAP reported earnings were \$1.02 per share and there were no special items of a nonoperational nature. This compares with adjusted earnings of \$0.84 per share in the first quarter of 2014, an increase of 21.4%.

As a reminder, the adjusted EPS of \$0.84 last year did not reflect 100% ownership of Wireless for the full quarter since the Vodafone transaction closed on February 21, 2014.

As we indicated a year ago, on the non-GAAP illustrative basis, adjusted earnings for the first quarter of 2014 would have been \$0.91 per share if we assumed 100% Wireless ownership for the full quarter. On this more comparable basis, growth in the first-quarter earnings per share was 12.1%.

I would also like to make a few points about our Wireline segment reporting. Our Wireline results include the operations we are selling to Frontier until the transaction closes, which is targeted for the first half of 2016. Our consolidated balance sheet reflects the assets and liabilities associated with those operations as being held for sale.

This is important because accounting rules require that depreciation expense not be recorded on assets held for sale. Therefore, Wireline depreciation expense will be lower in 2015 due to the classification of these assets. The first quarter included a \$146 million pretax benefit, which equates to roughly \$0.02 per share. Going forward until closing, the full-quarter benefit will be approximately \$200 million pretax, or \$0.03 per share.

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

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

Thanks, Mike. Good morning, everyone. We are off to a strong start in 2015, with an eventful first few months behind us. We continue to execute well on our strategy of investing in networks and platforms and positioning the business for future growth. We delivered very strong financial and operating results in the first quarter with strong cash generation.

To review our active start to the year, we were successful in the AWS-3 spectrum auction, improving on our mid-band spectrum position while maintaining sound financial discipline. As we stated on our conference call in mid-February, we are very pleased with the licenses we won and are confident that they will enable us to execute efficiently on our network strategy of adding capacity through a combination of spectrum deployment and small cell technology.

Our early experiences with small cell deployment have been very favorable and we believe that the industry is making good progress on standards for utilizing unlicensed spectrum with LTE, which is already being tested in our vendor labs. We also executed several value-creating transactions that underline our commitment to extend our industry leadership in the markets we serve by being strategically focused and returning value to shareholders.

We successfully monetized our tower portfolio in a \$5 billion transaction with American Tower, which closed at the end of the first quarter. We signed a definitive agreement to sell our Wireline properties in Florida, Texas, and California to Frontier for \$10.5 billion. And we implemented a \$5 billion accelerated share repurchase program, which resulted in an immediate reduction of about 86 million shares in mid-February.

Final settlement of this transaction, including delivery of the remaining shares that we expect to receive, is scheduled to occur in the second quarter. Collectively, these transactions provide immediate value for shareholders.

Now let's move on to our primary focus, which is executing our day-to-day strategy for the benefit of our customers and shareholders. Our first-quarter results reflect strong top- and bottom-line performance. We posted solid revenue growth, high-quality earnings growth of 12%, and generated substantial free cash flow.



In Wireless, we had a solid quarter of quality connections growth and profitability. We had 565,000 retail postpaid net adds in a seasonably low-volume quarter. Total Wireless revenue grew 6.9% and EBITDA was up 6.6%. As expected, our Wireless EBITDA margin returned to more historical levels.

In Wireline, consumer revenues grew 4% and we continued to increase our FiOS penetration with quality customer growth. Total Wireline revenue was impacted by foreign-exchange pressure, but our continued focus on productivity improvements and operating efficiency resulted in EBITDA margin expansion.

Now let's get into the first-quarter performance in more detail, starting with our consolidated results on slide 4.

Total operating revenue grew 3.8% in the first quarter, continuing our consistent top-line growth trend. If we excluded the first-quarter 2014 revenues from the public sector business we sold, the comparable growth rate would have been 4.2%.

Our consolidated revenue growth continues to be driven by wireless and FiOS. New revenue streams from the Internet of Things and Telematics continue to emerge and grow. In the first quarter, these revenues totaled approximately \$150 million, an increase of 25%.

We continue to build upon our Internet of Things and video platforms. In particular, innovation within the transportation industry presents a great opportunity for us. Through Verizon Telematics, we are already providing a platform of manufacturer, aftermarket, and fleet services through two-way broadband connectivity to vehicle. Additionally, we will be launching Verizon Vehicle, our direct-to-consumer aftermarket product, which modernizes traditional roadside assistance and enhances driver safety and convenience.

In terms of video, we are on track to launch our mobile-first OTT video product this summer and we have already announced some initial content partners. We are excited about these new growth opportunities, which you will hear more about during the year.

In addition to top-line growth, we continue to focus on process and operating efficiencies and improving our cost structure. Consolidated EBITDA totaled \$11.9 billion in the quarter, up 5.8%, and our EBITDA margin expanded by 60 basis points on an adjusted basis to 37.4%. As Mike indicated, we reported \$1.02 in earnings per share in the quarter for a comparable growth rate of about 12%, so we are off to a strong start from an earnings perspective.

Let's turn now to cash flows and the balance sheet on slide 5.

Consistent with the capital allocation model we have been executing the last several years, our priorities are to invest in our networks through capital spending and spectrum acquisitions, return value to shareholders, and maintain a strong balance sheet. Our strong cash flows enable us to execute on this investment strategy, pay competitive dividends, and delever the balance sheet. The monetization of our tower portfolio enabled us to execute the \$5 billion accelerated share repurchase program.

In the first quarter, cash flows from operations totaled \$10.2 billion. This included approximately \$2.4 billion related to the tower monetization transaction, which is nonrecurring. The remaining portion of the \$5 billion of cash proceeds is reflected in the financing activities section of the cash flow statement.

We also securitized a portion of our wireless equipment installment receivables and received \$1.3 billion in cash proceeds during the quarter. Free cash flow, excluding the tower proceeds, totaled about \$4.2 billion. Capital expenditures were \$3.7 billion in the quarter. Although spending was slightly lower in the first quarter, we expect 2015 capital expenditures to be within our stated range of \$17.5 billion to \$18 billion.

In Wireless, we continue investing to proactively stay ahead of demand. In the first quarter, Wireless CapEx totaled \$2.4 billion. As we have previously stated, our capital investments are focused on adding capacity to optimize our 4G LTE network, primarily by increasing network density.

We are deploying existing AWS spectrum in addition to utilizing small cell technology, in-building solutions and distributed antenna systems. We are also beginning to re-farm our 1900 PCS spectrum from 3G EVDO to 4G LTE in select markets.



Despite what others claim about certain network metrics, we are consistently acknowledged as the overall 4G LTE network performance leader in national studies conducted by widely-recognized third-party organizations. We lead in what matters most to customers, coverage and consistent performance, and continue to be the largest and most reliable 4G LTE network in the nation.

Our balance sheet remains strong and we continue to have the financial flexibility to grow the business and pursue our strategic goals. Our financial deleveraging plan had always assumed the purchase of new spectrum.

In the first quarter, we paid the remaining balance of \$9.5 billion for the AWS-3 licenses we won in the auction. During the past six months we have been very active in the debt capital markets managing our maturities and taking advantage of the interest rate environment. We ended the quarter with \$113.4 billion of gross debt, net debt of \$109 billion, and a ratio of net debt to adjusted EBITDA of 2.5 times.

We are on track with the plans to delever and remain committed to returning to our pre-Vodafone transaction credit-rating profile in the 2018 to 2019 timeframe. Now let's move into a review of the segments, starting with Wireless on slide 6.

Our Wireless strategy is to provide the best customer experience while continuing to invest in our network to stay ahead of accelerating demand and higher customer usage. Wireless revenue growth, profitability, and cash flows continue to be driven by our high-quality retail postpaid customer base.

Total Wireless operating revenues were \$22.3 billion in the first quarter, up 6.9%. Total service revenue of \$17.9 billion declined 0.4%. Keep in mind that lower service revenue from Edge customers have shifted to equipment revenue. Service revenue plus Edge installment billings were up 3.1%.

During the quarter, customer demand for our Edge equipment installment plan continued to increase. The percentage of phone activations on the Edge program was about 39%, compared with about 25% in the fourth quarter. We expect the percentage of phone activations on Edge to increase in the second quarter as we are currently running near 50%.

Edge phone activations totaled \$3.4 million in the quarter and we now have an Edge phone base of 10 million, representing 11.7% of our postpaid phone base.

In terms of profitability, we generated \$10 billion of EBITDA in the quarter, an increase of 6.6%. Our EBITDA service margin increased to 55.8%, up 370 basis points year-over-year. As customer acceptance of equipment installment plans evolves and the percentage of Edge adoption increases, equipment revenue is increasing. Therefore, you should look at EBITDA margin on total Wireless revenue rather than Wireless service revenue. On this basis, our EBITDA margin on total Wireless revenue was 44.8% in the quarter, which was similar to a year ago.

Now let's turn to slide 7 and take a closer look at Wireless connections growth.

We ended the quarter with 108.6 million total retail connections. Our industry-leading postpaid connections base grew 5.5% to 102.6 million and our prepaid connections totaled 5.9 million. As expected, first-quarter seasonality resulted in lower volumes.

Postpaid gross additions were 3.7 million, up 2.3% compared to a year ago. A majority of the gross adds were 4G smartphones and tablets. Retail postpaid churn improved both sequentially and year-over-year, coming in at 1.03% for the quarter.

We are maintaining a disciplined approach with a focus on retaining high-value customers. We are seeing good results with our postpaid smartphone churn, less than 0.9% as compared to our basic phone churn at more than 1.2% in the quarter.

Our retail postpaid net additions of 565,000 were up 4.8%. The quality of the net adds was very good. We added 621,000 new 4G smartphones and total net smartphone adds were 247,000 in the quarter. We also added 820,000 new 4G tablets.

Postpaid phone net adds were a negative 138,000 as the smartphone adds were more than offset by a net decline of 385,000 basic phones. Additionally, net prepaid devices declined by 188,000 in the quarter.



Let's now take a look at 4G device activations and upgrades on slide 8.

Total postpaid device activations totaled 10.3 million in the quarter, up 4.4%. About 84% of these activations were phones and the rest were mainly tablets. We ended the quarter with 68.7 million smartphones in total, about 85% of which were 4G. Our smartphone penetration increased to approximately 80% of total phones.

4G devices now comprise approximately 70% of our retail postpaid connections base. About 86% of total data traffic is on the 4G LTE network. As you would expect, growth in 4G device adoption continues to drive increased data and video usage.

Within More Everything amounts, average data usage continues to rise, up 54% year-over-year. This is beneficial to us because increasing consumption of content will ultimately drive higher revenue with a lower cost to serve due to the efficiency of our LTE network.

In terms of our upgrade rate, about 6.5% of our retail postpaid base upgraded to a new device in the first quarter. This represents a sharp sequential decline in the percentage of customers upgrading, which was expected due to seasonality and the extraordinary volumes we experienced in the fourth quarter.

We continue to have an opportunity to upgrade our basic phone and 3G smartphone customers to 4G devices. At the end of the quarter we had roughly 17 million basic phones and about 11 million 3G smartphones remaining in our postpaid connections base.

We also have a profitable growth opportunity with tablets. We ended the quarter with about 8.8 million tablets in our postpaid connections base, so overall penetration is still under 10%. Tablets provide us a good value through increased data consumption and lower churn at the account level.

Let's move next to our Wireline segment, starting with a review of our consumer and mass markets revenue performance on slide 9.

In the consumer business we continue to see positive revenue trends driven by FiOS. In the first quarter, consumer revenues were up 4%, representing the 11th consecutive quarter of 4% or better growth. Mass markets, which include small business, grew 2.9%.

FiOS now represents 78% of consumer revenue. In the first quarter, FiOS consumer revenue grew 9.8%, driven by customer growth, increased penetration of our Quantum products, and some pricing actions. Our FiOS Quantum broadband service is scaling well and has a higher profitability contribution.

At the end of the quarter, 62% of our consumer FiOS Internet customers subscribed to data speeds of 50 megabits per second or higher. We are seeing the highest rate of growth in the 75 megabits speed tier, where just over 20% of our consumer FiOS customers currently subscribe.

We had a good quarter of FiOS customer growth. In broadband, we added 133,000 net FiOS customers and now have a total of 6.7 million FiOS Internet subscribers, which is 41.5% penetration. Overall, net broadband subscribers increased by 41,000 in the quarter.

In FiOS Video, we added 90,000 net customers in the quarter and now have a total of 5.7 million FiOS Video subscribers, which represents 36% penetration. One of the ways we strive to improve the customer value proposition is by creating new and innovative services on our FiOS platform. Last year we introduced Quantum TV, SpeedMatch, and our Quantum Gateway router.

As part of the evolution of customer choice for video consumption, we just introduced FiOS Custom TV just in the last few days. The Custom TV option is a creative approach to the changing landscape, allowing customers to better choose the type of content they want to watch. Customers will get a base package of preselected and local broadcast channels and choose at least two channel packs out of seven. This new option, coupled with our traditional programming packages provides more choice, more control, and more value in an easy self-serve manner.

In terms of our ongoing network evolution initiative, we converted about 47,000 copper customers in the quarter. For the year, we plan to convert a total of 200,000 copper customers to fiber. We are also in the process of decommissioning 10 central offices.



Post-conversion we are seeing improvements in customer satisfaction and a lower cost to serve. These conversions also provide a long-term opportunity for customers to purchase FiOS services from us. Our focus in 2015 will be to continue adding quality customers, driving higher penetration in existing markets, and generating profitable growth. Residential broadband and video are highly competitive markets and we will be disciplined and rational in our approach to customer acquisition.

With that, let's turn to slide 10 and cover Enterprise and Wholesale as well as the Wireline segment in total.

In the Enterprise space, we continue to work through secular and economic challenges. In the first quarter, global Enterprise revenue declined 6%. Excluding foreign exchange pressure, the revenue decline would have been more in line with trends we experienced in the second half of 2014.

The overall story is unchanged as declines in legacy transport revenue and CPE continue to outweigh growth in newer and more strategic applications, which are smaller in scale. Revenue from services in the IP layer has been impacted by competitive price compression, which is offsetting growth in applications and services.

In our global wholesale business, revenues declined 3.7% in the first quarter. Healthy demand for Ethernet services continues, but revenue declines from price compression, technology migration, and other secular challenges more than offset this growth. We also had a favorable contract settlement, which improved revenue this quarter and which will not recur.

Total operating revenues for the entire Wireline segment were down 2%, which included the FX pressure.

In terms of profitability, the EBITDA margin was 22.7% in the quarter, up 20 basis points. Our path to a stronger and more profitable Wireline business includes driving further FiOS penetration and continued improvements in operating and capital efficiency.

On the enterprise business side, we are changing the revenue mix to higher growth areas like cloud, security, and professional services. In terms of our cost structure, we are realizing a number of noteworthy process improvements and efficiency gains utilizing our Verizon Lean Six Sigma principles. However, we are far from satisfied and will continue working to improve our overall cost structure.

Let's move next to our summary slide. We're off to a strong start to 2015. From a strategic standpoint, we were successful in the spectrum auction, executed a tower portfolio monetization, and signed a definitive agreement to sell certain Wireline properties. At the same time, we returned value to shareholders with an accelerated share repurchase program. We also delivered strong operating and financial performance, with 12% growth in earnings per share on an adjusted basis.

Our first-quarter results demonstrate that we are in a strong market position with a proven ability to compete effectively and execute our strategy. Our high-quality customer base and superior networks are the hallmark of our brand and provide the fundamental strength upon which we will build our competitive advantage. We are on track to achieve our targets of at least 4% consolidated revenue growth, sustained profitability, and capital spending in a range of \$17.5 billion to \$18 billion in 2015.

Consolidated EBITDA grew by 5.8% and our EBITDA margin expanded to 37.4%. In addition to our ability to deliver strong financial metrics, we are very focused on developing new products and services in the Internet of Things and video. We are excited about the potential for revenues from these new products and services to grow quickly and become more meaningful in the future. Our deleveraging plans are on track and we remain committed to getting back to our pre-Vodafone transaction credit rating profile in the 2018 to 2019 timeframe.

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

Michael Stefanski - Verizon Communications Inc. - SVP, IR

Thank you, Fran. David, we're now ready to take questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Simon Flannery, Morgan Stanley.

Simon Flannery - Morgan Stanley - Analyst

Thanks very much. Good morning, Fran. You had a couple of management changes in the first quarter; John Stratton taking over as president of operations and combining the IT and network units. Can you give us a little bit of color of any sort of implications of any strategies or anything that has happened as a result of that? Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Sure. Thanks, Simon. As we have moved into our next phase, as Lowell has consolidated the operational performance under John, this gives us a better breadth of consolidation, if you will, post the Vodafone acquisition. And if you go back to when we did the acquisition, we stated that there were some internal walls that could be broken down and we could become more efficient.

With the establishment of Marni Walden's organization around new products and services, this is where we get into the Internet of Things and over-the-top video. She runs Verizon Digital Media Services and some of the other incubation companies that we have. So the focus is running the day-to-day operations out of John's organization and streamlining, implementing Verizon Lean Six Sigma and driving those cost benefits and efficiencies that we are looking for.

With Marni's organization, it's creating the new products and services that we can launch to grow the future of the business. And then with Roger and the consolidation of the network and the IT organization, it just makes sense as we move into more software-developed network areas and more of the network is driven out of data centers, it makes sense that Roger would take over the entire thing from an efficiency and consistency of management perspective.

So I think what you're seeing here is more well-organized within the Company, more cohesiveness, and more direct relationship between growing revenue and cost reduction.

Simon Flannery - Morgan Stanley - Analyst

Okay, great. So no real changes in the cost trajectory or the CapEx trajectory?

Fran Shammo - Verizon Communications Inc. - EVP & CFO

CapEx we have given you guidance of \$17.5 billion to \$18 billion and right now we're staying on track with that. You should see that ramp through the rest of the year, and obviously coming out of the auction we added \$500 million to that to densify and buildout, and that takes a little bit of queuing up time. So you will see that more in the back end of the year.

As far as cost reductions, you've seen some of the measures we took at the end of the fourth quarter. If you look at Wireline alone, Wireline is down over 5,400 people from beginning of last year, so continuing to streamline that business and become more efficient. And for Wireless, as John has taken over, we're starting to see some streamlining around customer service and some of the other things that we've talked about in the past. So I wouldn't downplay the cost reductions that we will realize in the future here.



Simon Flannery - *Morgan Stanley - Analyst*

Great, thanks for the color.

Operator

David Barden, Bank of America.

David Barden - *BofA Merrill Lynch - Analyst*

Thanks for taking the question. Maybe just two, if I could.

Fran, on the quarter I think the two numbers that really stood out to people were, number one, the really low SG&A in Wireless. I think going back to our model, maybe the lowest percentage of Wireless revenue we've ever seen. If you could kind of step us through how we got there from last quarter and what the outlook for that would be, it would be huge.

Then the second big number was really the ARPA number, which I think stepped down further than people thought. That could have been related to EIP or it could have been the pricing environment in the market or retention efforts that you're executing on. Could you kind of give us a picture for how we got to where we got in ARPA and how we can think about that for the rest of the year? Thanks.

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

Just a clarification, on the Wireless revenue you're talking about service revenue?

David Barden - *BofA Merrill Lynch - Analyst*

I was actually talking about total revenue as a percentage of SG&A, but either way it was a really low number.

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

Look, I think that if you look at service revenue and ARPA it all goes to the same issue, which is as we start to elevate Edge and we start to increase the take rate of Edge and customers move, you are shifting revenue out of service and into equipment. So you are going to continue to see a decline in service revenue. You're going to continue to see a decline in ARPA.

But I think what I would center around is what we said in the script, which was we grew overall revenue by 6.9%. And also if you look at the EBITDA margin, which kind of normalizes out the Edge impact -- not 100% of it, but if you look at \$1 of revenue and \$1 of cost, they are zero margin. So if you look at total revenue, 44.8% versus last year at 44.9%, so it's a very consistent profitability measure.

The other thing, too, is if you look at the Edge benefits, you are getting benefits from both lower commissions and so forth, so that is also impacting the SG&A line. Because your indirects -- before if you think about how that worked, we were refunding the indirect through a commission payment for the subsidy of the handset. That all goes away so you are going to see a decline in the commission expense line, which is impacting the SG&A line.

But, overall, if you look at the profitability of Wireless -- and I think this is important. If you look at the service margin of 55.8%, if you were to normalize out Edge, the Wireless service margin would still have been over 50%. So the profitability of Wireless continues to be extremely strong and, again, I would go back to what Simon brought up: I would not discount all of the cost reductions and efficiencies that we are creating in the environment.



David Barden - *BofA Merrill Lynch - Analyst*

So this is a good baseline for extrapolating the rest of the year?

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

Well, from a rest-of-the-year standpoint, I think that the outlook is strong. I think that obviously as Edge continues to escalate you are going to get some benefit there. We highlighted the depreciation benefit.

But I think as far as Wireless goes, I think we need to be careful here a little bit because January normally is a slow promotional, slow seasonal quarter. As you go into the second quarter and you enter into Mother's Day and Father's Day, I would expect that the promotional activity and competitiveness is going to heat up here. So that will offset some of the benefits that you are going to see.

Look, I think that service revenue and ARPA will continue to decline as the Edge rate takes up, but it's really about overall revenue growth and the profitability of the business. And we feel good about that.

David Barden - *BofA Merrill Lynch - Analyst*

Perfect. Thanks, Fran.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - *JPMorgan - Analyst*

Thanks. I guess, first, if I can follow up; Fran, on the Edge stuff, can you help us with the high end of the Edge mix, given the distribution of where you sell this? What portion of your sales are in channels that don't have access to the Edge program?

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

Well, all of our channels have access to the Edge program, but obviously within our store channel it is very, very heavily weighted towards Edge at this point. We are doing very little subsidy model selling out of the store channel, and it's because of where the market has moved.

When your entire competitive environment is just advertising and promoting service pricing and ignoring the whole equipment side, we have to follow that in order to be competitive. So the store channel, by far, is very heavily weighted towards Edge.

Indirect is starting to come up as time goes, but also keep in mind the business channel and our enterprise channel are not really taking the Edge products. So if you're asking me we will get to 100%, the answer is no. I can't tell you exactly what that percent will be, but we do see that second quarter we will probably be in the neighborhood of a 50% take rate.

Phil Cusick - *JPMorgan - Analyst*

Second, I like the Custom TV launch this morning. There is some controversy around ESPN and Disney. Can I ask do you guys have explicit permission for this and have Disney and others pushed back since Friday to you or is this just a storm in the media? Thanks.



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

Well, I think the right way to answer this without getting too public about our contractual situations, look, this is a product that the consumer wants. It's all about consumer choice.

If you look at the TV bundles today, most people only on average watch 17 channels, so this is a way to give consumers what they want on a choice basis. And we believe that we are allowed to offer these packages under our existing contracts, so we will leave it at that.

Phil Cusick - *JPMorgan - Analyst*

Thanks, Fran.

Operator

Mike Rollins, Citigroup.

Mike Rollins - *Citigroup - Analyst*

Thanks, just a couple follow-ups and a question. The follow-ups are, first, can you just give us the ending net receivable balance for the installment phones and what that was last quarter? And then are you allowing for installment plans early migration? Is that something you are using to get the take rate of Edge up?

And then just a broader question I had, if I could. Could you just address the larger strategy for Wireline? You went through a quarter of monetizing some additional -- or announcing the monetization of some additional assets. What are your thoughts longer-term for your Wireline business? Thanks.

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

Thanks, Mike. So on the accounts receivable I'm not going to get too much detail here on this call, but if you look at the fourth quarter to the first quarter, with the securitization that we did it's relatively flat.

On early migration on Edge customers, obviously we have an Edge Up feature, but you must pay 75% of the phone off. So if you decide to pay 75% of your balance off, you can upgrade at any point in time you want, and we do have customers who are taking that and Edging Up. But there is no, quote, early migration other than what's instituted in the price plan.

On the Wireline strategy, look, if you looked at the three properties that we announced to sell -- Florida, Texas, and California -- they were more or less islands to us. They were some of the first properties we built out with FiOS. They are heavily-penetrated properties, but the majority of those properties are still copper. And as we looked at that strategically, when we laid this out it just made sense, based on the offer that Frontier had in front of us, to actually sell those properties.

So I wouldn't read too much into it other than the fact that they were not strategic properties because they were islands. But if you look at the rest of our Wireline footprint, from DC all the way up through Boston, it's very contiguous. It's highly populated.

We have almost 20 million homes passed now with FiOS, so it's extremely viable for us to continue to penetrate these properties. And if you look at the penetration rates, New York is still the lowest-penetrated market that we have and still has the highest growth opportunity that we have.



So we're holding on to some of the markets that we believe are contiguous. You will see more and more with Wireless and Wireline combined under John's leadership. So there's more that we can do strategically with the footprint that we have. Again, it just made financial sense to return that back to our shareholder and bring that cash into delever the balance sheet.

So that's really all there is to it, Michael.

Mike Rollins - *Citigroup - Analyst*

Thanks very much.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - *Goldman Sachs - Analyst*

Thanks for taking the question. The smartphone metrics continue to be really impressive, but as you note in the presentation, about 20% of your sub still have feature phones. So I was wondering if you could just walk us through what is the strategy for upgrading and retaining those subs? Particularly because it seems that your competitors are continually targeting that base.

And should it be reasonable to think that at this point in the upgrade process we might continue to see some modest degree of net losses in the phone base? Or is what we saw in the first quarter just a seasonal factor?

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

I guess a couple things here. So we still have 17 million basic and 11 million 3G phones. Coming out of the fourth quarter you heard me say that we were going to protect our base, and that was a key ingredient going into the first quarter.

I think with the churn rate you have seen, if you look at the basic phone losses on a year-over-year basis, we actually improved that by over 400,000. So last year we had almost double the number of basic phone loss customers than we did this year. And as you noticed, we came out with some strong promotional pricing that was targeted towards the basic phone customer and the 3G customer.

Now having said all that, look, the environment is that there -- if you look at prepaid just on a standalone basis, our prepaid retail pricing is slightly at a premium to some of the other competitors' postpaid pricing. So we are in a competitive pricing standpoint and, as I said coming out of the fourth quarter, we will not -- we have to be rational and we will not chase every customer. But we are making every effort to maintain our base and keep our customers and upgrade them into a price plan that's fitting for them. We made improvement in that, but I will tell you we still have some more improvement to do.

But we are not satisfied with any losses, but then again, we will not chase every add either based on just cheap price. So I think that's the balanced equation that we showed in the first quarter.

Brett Feldman - *Goldman Sachs - Analyst*

And just a quick follow-up. I believe in the past you've said some of the small losses you've seen have generally been customers that were not as profitable. Is that still the case?



Fran Shammo - Verizon Communications Inc. - EVP & CFO

Well, I think what I said was if it's -- not quite, I wouldn't put it in a profitability perspective, but what I would say is if it's a customer who is just price sensitive and does not care about the quality of the network or is sufficient with just paying a lower price, then that's probably a customer we're not going to be able to keep on the Verizon Wireless network.

Brett Feldman - Goldman Sachs - Analyst

Thanks for taking the question.

Operator

Mike McCormack, Jefferies.

Mike McCormack - Jefferies LLC - Analyst

Thanks. Fran, maybe if you could just comment regarding subscriber quality, maybe net add quality or base quality, and just thinking about the credit scores within the base or the prime mix. Obviously, we've seen a lot of prepaid migration into postpaid; just what you guys are seeing with respect to that.

As a follow-up, just a comment, if you would, on the appetite for additional factoring; how we should be framing that for the full year. Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Sure. So on the securitization piece of the business, yes, you should anticipate that this will be an ongoing program on a quarterly basis going forward.

As far as the quality of our base, I think the quality of our base speaks for itself. We have not made any credit policy changes. We have a very strong quality base, but there are a certain segment of our customers, as I just discussed, around basic where we are trying to bring them up into a price plan that is meaningful for them.

But if you look at the lay of the land around price trends, as I said our prepaid pricing is a little bit of a premium from some other postpaid pricing in the market place. And as you saw this quarter, we lost 188,000 prepaid retail customers. I can't answer specifically where they went, but I would say that they probably made a choice to go to a price -- a postpaid price plan because it's actually slightly lower on some competitors than it is with us on prepaid.

So I can't factually state that, but I think that is some of the migration. But also I would also say that on the reseller side, which we don't talk much about, we had a very strong growth through our TracFone relationship, over 400,000-and-some net adds this quarter. So it could have been a migration from retail to wholesale, but I do think there is a migration from the prepaid base into some other postpaid bases. And I think others will have to talk to that, but we're not seeing a lot of that within our base.

Mike McCormack - Jefferies LLC - Analyst

Fran, just how you frame the credit risk on these installment plans? I am assuming you guys obviously have pretty tight credit standards, but do you see this as a risk for you guys and the industry just having more and more loans out there for Apple phones?



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

Sure, obviously it adds risks to the balance sheet because you're putting up a very large receivable now. Before it was just service revenue that you were at risk for, and if you looked at the economics of service revenue, it really is what's the economic loss to the Company. Really it comes down to what's the actual economic loss of providing the service to the customer. It's not actually the retail service revenue that's the loss.

Obviously, the cost of service is minimal so the loss was a lot less. Now you're actually putting up a receivable that has a dollar-for-dollar loss if the customer does not pay.

Again, we are very comfortable with the credit models we use. As I said, we really haven't changed our credit and we have a very strong credit base. I'm not -- at this point, I don't see any trends that would be concerning me on the outstanding receivable at this point.

Mike McCormack - *Jefferies LLC - Analyst*

Great. Thanks, Fran.

Operator

John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Thanks, two quick ones. First, following up on the video tiering, Fran. Could you talk a little bit about maybe sort of expected penetration that you expect with these new plans, and maybe compare the profitability of these new services to traditional TV subscriptions?

And then, from an Edge standpoint, you have guided to flat consolidated margins for the year, but as you see the higher take rate of Edge, and first of all where that could go for the year, could that drive better wireless margin trends and lead to better overall consolidated margins for the Company? Thanks.

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

Thanks, John. On the video tiers, look, I think it's way, way too early to start talking about what the take rate is or the profitability, so we will leave that until we get some trending behind us. Obviously we have done this because of consumer benefit, give the consumer a better choice. So let's see what happens here as we go and then we can address that later.

On the EBITDA margins, look, I'm kind of reiterating our guidance that we came out of the fourth quarter from an outlook perspective, and I think that you have to be cognizant of the fact that this is the first quarter of the year. If you look at last year's trending, as we said, coming out of the Vodafone transaction our earnings profile would be more consistent across the quarters. We wouldn't be as bumpy as we had been in the past.

I think that you have to look at the whole thing in retrospect. And also, the other thing is I would not get focused in on the service margin side and, as I said, I'd really prefer us to look at the total revenue and the EBITDA margin. And if you saw, the EBITDA margin was very, very strong for Wireless this quarter.

And that kind of normalizes out a little bit of what the Edge take rate is. Then again, I also can't speak to what we're in for from a competitive standpoint on additional pricing moves through the year, so I'm kind of reserving on that side of the equation as well from an outlook perspective.

On outlook and profitability I would say, reiterating what we said in the fourth quarter and more consistent earnings profile moving forward. So I think that's where we will leave it.

John Hodulik - UBS - Analyst

Great, thanks, Fran.

Operator

Amir Rozwadowski, Barclays.

Amir Rozwadowski - Barclays Capital - Analyst

Thank you very much and good morning, Fran and Mike. You folks highlighted that 4G devices now constitute approximately 70% of the retail postpaid connections and that traffic or LTE network handles about 86% of the total Wireless data traffic for the quarter.

Given these dynamics, what seems to be a rapid adoption of LTE technology, I was wondering if you could give us an update on your ability to re-farm spectrum in order to take advantage of the network efficiency opportunity. Fran, you had mentioned that there are continued cost-reduction opportunities that your scale provides you and any color there would be helpful.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Sure. Thanks, Amir. I think that this is all pointing to where the future growth of the business comes from. There's not many businesses where consumers want to consume more and more. And if you look at it, 86% of the usage is on the LTE network, and if you look at our More Everything accounts, they are up 54% in consumption year-over-year.

So obviously consumers are willing to consume the content on their wireless devices, which is why we were so optimistic around Internet of Things and, of course, over-the-top mobile. Now as you start to look at the densification and the efficiency of the network, as I said in my prepared remarks, we are already starting to re-farm the 1900 PCS licenses in certain markets and we still have a long way to go there.

Also we are looking at, as I said, the LTE unlicensed, which is a really good fit with the licensed LTE piece, which will give us a lot more download capability and a managed network comparability. So there's a lot that we can still do around our spectrum and efficiency. And obviously, with the LTE network, as you have seen, with 86% of that traffic running on it with a 54% overall year-over-year increase, the cost structure of the business really has not changed, because the ability to deliver this on a very cost-efficient network is there.

So I would just continue to say that as we continue to grow on the consumption model, what we did in the AWS spectrum in buying the licenses and our plan to build out and densify, I think we are in a very good financial position to execute on that in a very financially disciplined manner and continue to generate the returns that are expected of us.

Amir Rozwadowski - Barclays Capital - Analyst

Great. And then one quick follow-up, if I may. You folks have been consistent noting that deleveraging the balance sheet is a priority for you. As you mentioned, it seems as though the approach you took to the AWS-3 bidding process seems to reflect that strategy.

How should we think about your ability or resources available to pursue other assets in the market? Specifically I'm thinking about the potential broadcast spectrum auction or any material third-party portfolios, if they were to come to market?



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

Look, we are very focused on our balance sheet and we are committed to delever. And as we said coming out of the Vodafone transaction, we had four priorities. One was to continue to invest in our networks and platforms, which we are; to buy spectrum, which we did; to have a competitive dividend payout, which we do; and to delever the balance sheet. And we're continuing to do all that.

As far as any type of strategic acquisitions or additional spectrum, we are probably alluding to the incentive auction and I think that we are just going to have to wait and see what the rules are before we decide how we're going to execute on or around the incentive auction. So I think that is still a little bit ways out before we can make that decision.

But, look, we have positioned the balance sheet to be able to execute on the strategies that we need to execute on in order to deliver the future growth and earnings of the business. And I think we're in a very, very sound position to do that.

Amir Rozwadowski - *Barclays Capital - Analyst*

Great, thank you very much for the color.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - *Wells Fargo Securities - Analyst*

Fran, thank you for taking the question. I wanted to ask about the over-the-top video service offering.

I know we're going to see a more formal unveiling this summer, but can you just discuss the news floor, what we should be honing into as you go into that announcement? I assume it's more content announcements.

And then, on the packages you announced last week, should we consider this separate from the OTT or kind of a precursor of this integrated Wireline -- Wireless model?

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

Okay, first on over-the-top video. As we have talked before, you see us announcing some of the content deals that are in this, but it goes back to what I said before. This is all around having the consumer consume more content on their wireless handset through the Verizon Wireless network.

And we know that consumers want content. We know what the viewership is, and this is appealing to mobile content. Let's not confuse that with linear TV content. So I would not read into the Custom TV package as a precursor to the over-the-top video, it's not. These are two very distinct ecosystems.

As far as the monetization model, when you think about the monetization, there's many different avenues we can do on this. There could be premium subscriptions. There could be pay-per-views using the multicast technology. There can be advertising models so that the consumer does not pay for the content consumption. Or, as others would call it, sponsored data.

So I think there's a lot of models that we can use, and I hate to say this, but let's wait until Marni and team are ready to make the big splash here this summer. And then we can have more discussion around what it means.

Jennifer Fritzsche - Wells Fargo Securities - Analyst

Great, thank you very much.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

David, we have time for one more question.

Operator

Tim Horan, Oppenheimer.

Tim Horan - Oppenheimer & Co. - Analyst

Thanks, guys. Fran, the wireless data growth is fairly incredible at this size and base. Do you think you have pricing power for wireless data? Two of your competitors aren't really charging all that much for it. Do you think that will change in the industry as maybe the networks get filled up? Your thoughts, thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

I think this is a great lead way into the over-the-top mobile, and it is developing more ecosystems around monetizing the consumption that happens on the network. Obviously, we are in a period of time where we see this service pricing dilution because of the installment sale, and I think that will continue. And of course, we are increasing bundles, so more data for the same price.

But this is no different, Tim, than what we saw in the voice world way back where we had a price and then all of a sudden everybody started seeing dilution on the per minute price because more minutes were being given away in the bundle. And we saw a little bit of access accretion, but overall pricing was coming down.

Then, all of a sudden, the usage track started up again and revenue took a turn. I think that's the piece that we are in right now with the data world.

But the key to this is to develop these other ecosystems to create more monetization around customer usage, whether that's premium subscription, pay-per-view, or advertising models. And that is really what we are concentrating on.

Tim Horan - Oppenheimer & Co. - Analyst

Thank you.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

David, thank you. Before we end the call I would like to turn it back to Fran for a few closing remarks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Thanks, Mike. Thanks, everybody, for joining Verizon this morning.

We are absolutely off to a good start to the year. We stated coming out of the fourth quarter that we would return to historical margins in Wireless, and we delivered on that. We also stated that we would continue to improve the profitability of our Wireline business, and we delivered on that.



We had a good growth quarter. We had strong profits and strong cash flows. We look forward to a very positive 2015, and we look very hopeful and are confident in our ability to execute on our strategy, grow the business profitably, and invest for the future.

Thanks, everyone, for joining us 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.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2015, Thomson Reuters. All Rights Reserved.