# FINAL TRANSCRIPT

## Thomson StreetEvents℠

# VZ - Q2 2010 Verizon Earnings Conference Call

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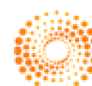

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## PRESENTATION

**Operator**

Good morning and welcome to the Verizon second-quarter 2010 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. Ron Lataille, Senior Vice President Investor Relations for Verizon.

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**Ron Lataille** - *Verizon - SVP, IR*

Good morning and welcome to our second-quarter 2010 earnings conference call. Thanks for joining us this morning. I'm Ron Lataille. With me this morning is John Killian, our Chief Financial Officer.

Before we get started, let me remind you that our earnings release, financial statements, the investor quarterly publication and the presentation slides are available on our Investor Relations website. This call is being webcast. If you would like to listen to a replay, you can do so from our website.

I would also like to draw your attention to our Safe Harbor statement. 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.



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

On a GAAP basis, we reported a net loss for the second quarter of $0.07 per share. These quarterly results include a total of $0.65 of nonoperational or one-time charges, which are listed on slide four. The largest item relates to the recognition of costs in connection with our Wireline force reduction initiative, primarily for severance, special termination benefits and pension charges. These costs totaled $2.3 billion pretax and resulted in a charge to earnings of $0.52 per share. Roughly $1 billion of the pretax amount is for additional severance liabilities as a result of the enhanced incentive offer. The remaining $1.3 billion of pretax costs are non-cash and relate to the recognition of special termination benefits and pension plan liabilities for the affected employees.

We also incurred nonoperational costs in connection with the spinoff of our access line properties to Frontier. As we previously discussed, these costs are related to network, software and other activities required for these facilities to function as a separate company. In the second quarter, these "get ready" costs amounted to $195 million pretax or a charge of $0.04 per share.

Another item we have been pointing out for you are merger integration costs related to Alltel. During the second quarter, charges related to these activities amounted to $0.02 per share. In addition, the sale of the Alltel divestiture properties resulted in a one-time tax expense worth about $0.04 per share.

The last item that I would like to highlight is a one-time non-cash adjustment of $268 million, primarily related to Wireless data revenues. This adjustment was recorded to properly defer previously recognized Wireless data revenues that will be earned and recognized in the following period. As the amounts involved were not material to our consolidated financial statements in any current or previous reporting period, the $268 million adjustment was recorded entirely in the second quarter with an unfavorable impact on consolidated revenues, which equates to $0.03 per share of earnings. Consistent with our reporting methodology, the items I just described are not included at the segment level, primarily due to their nonoperational or nonrecurring nature. However, they are included in our reported consolidated results.

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

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**John Killian** - *Verizon - EVP & CFO*

Thanks, Ron, and good morning, everyone. Before we get into the details, let me start with some brief comments on the business overall and add some of my perspective to our second-quarter results. Our results show that we continue to do a good job executing in our key focus areas.

In terms of cash generation, we had an exceptionally strong quarter of cash flow growth with continued tight controls on capital spending. We saw good customer growth in Wireless where data revenue growth continues to be driven by smartphone sales to both new and existing customers. As a result, we saw increasing year-over-year growth in postpaid ARPU and improvements to our industry-leading customer retention metrics this quarter.

In Wireline our EBITDA margin improvement was driven by cost reductions. During the quarter we had approximately 11,000 volunteers for our enhanced separation offer in the East and mid-Atlantic regions. So this will go a long way toward helping us achieve our Wireline force reduction objectives for the year.

Broadband and video continue to drive revenue results within the mass markets. Revenue trends in global Enterprise improved again this quarter and showed positive year-over-year growth. And while we are seeing stability in underlying trends in the Enterprise space, we're still seeing cyclical effects and remain cautiously optimistic with regard to a more meaningful economic recovery.



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Lastly, we completed the pending transactions that were part of our overall strategic transformation. During the second quarter, we closed the sale of the 105 markets we were required to divest as part of the Alltel acquisition in 2009. And on July 1 we completed the access line spinoff and merger transaction with Frontier. Through the spinoff, Verizon shareholders received $1.85 per share in value in the form of Frontier shares and cash in what was effectively a stock dividend. So it was an active quarter for sure with solid overall performance.

Let's now move to our detailed review of the quarter, starting on slide four.

As Ron indicated earlier, our second-quarter earnings results included $0.65 of nonoperational or one-time charges. With a reported loss of $0.07, you can see that the math gets us to a $0.58 quarterly result. For the first half of the year, we produced $1.13 in EPS before the effect of nonoperational or one-time items.

I would like to add a little more detail on the Wireless deferred revenue adjustment. Over the last several years, we have moved away from billing customers on a "per use" basis for data to billing a "predetermined" price for either a bundle of text messages, a certain amount of data usage or unlimited usage of data on smartphones. As such, certain data services are billed in advance for services to be provided in the next monthly cycle. Essentially we are recording an adjustment related to prior periods in which we did not properly defer a portion of monthly billed revenues, primarily for certain Wireless data services that are billed in advance.

The impact of the deferred revenue adjustment in any given quarter or year was not material. So reported revenue and growth trends were not materially overstated. In fact, had we done this appropriately, the largest single year impact would have been under $80 million. However, since the amount of deferred revenue related to these types of data services had grown progressively over time, the $268 million adjustment does negatively impact consolidated revenues and our growth rates in the second quarter.

This is a one-time adjustment to reconcile our Wireless deferred data revenue balance. Given the nature of this adjustment, it is not included in our Wireless segment results and does not affect prior period comparisons at the segment level.

Let me now spend a minute on the divested properties, which will no longer be part of our results in the second half of the year. First, on the Alltel divestiture markets or "trust properties", as we refer to them, these markets were sold to two different buyers and closed on two different dates during the quarter. The first sale closed in late April and the second one in late June.

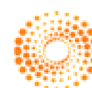
As such, our subscriber numbers at the end of the second quarter exclude the more than 2 million subscribers that we divested in these markets. Our quarterly financial results include these properties up until the date of each sale. But since both transactions closed during the quarter, our results do not reflect a full quarter of activity for the trust properties. The revenue impact of not having these Wireless properties for the entire second quarter is about $100 million.

We divested the Frontier properties on July 1, so those results are fully included in our second quarter. We will be providing pro forma historical information for our Wireline and Wireless segments to reclassify the impact of these dispositions in late August or early September. And I will talk more about the impacts of these divested properties on our 2010 earnings outlook at the end of my remarks.

Since a great deal of our earnings performance involves noncash effects, let's turn our attention now to cash flow, which presents a much different growth picture.

As I said earlier, our cash flow performance was quite strong. Cash flow from operations in the quarter totaled $9.8 billion. Year-to-date cash flow from operations of $16.9 billion is up 19.4%. Free cash flow in the second quarter was $5.5 billion, up more than 75%. On a year-to-date basis, free cash flow of $9.2 billion is up $3.1 billion or 52%. Our operational cash flow results continue to be very strong, and we have benefited from lower net tax payments.





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Looking at capital spending in total, we were down 3.6% in the quarter, and we are running 5% below 2009 on a year-to-date basis. So, at this point in time, I would reiterate our previously stated full-year 2010 guidance of capital expenditures between $16.8 billion and $17.2 billion.

And, as I previously said, we are re-allocating capital between our segments, reflecting growth opportunities. This shift will continue as we move through the year.

In Wireline, CapEx in the second quarter was $1.8 billion, down almost 24%. Year-to-date Wireline CapEx of $3.3 billion is down nearly $1 billion, reflecting lower FiOS deployment capital as planned and our tight focus on spending to increase free cash flow. In Wireless, capital spending is higher than last year, driven by 4G LTE network deployment and data capacity requirements. In the second quarter, Wireless CapEx was $2.3 billion. Year-to-date we spent $4 billion, which is up $698 million or about 21%.

Turning to the balance sheet, a top priority for us is to continue to reduce leverage. And we are doing well here with net debt of just under $53 billion at the end of the quarter, down $7.5 billion or 12.5% since the beginning of the year.

Our net debt to EBITDA ratio is about 1.5 times, and we're expecting it to be even lower by the end of the year. On July 1 we transferred $250 million of debt to Frontier and shortly thereafter used the $3.1 billion of cash from the spinoff to further reduce debt.

Let's turn now to revenue trends, which are on slide six. Consolidated revenues for the second quarter were $26.8 billion, an $88 million or 0.3% decline versus last year. The deferred revenue adjustment that I covered earlier had a negative impact on growth of about 100 basis points. And the timing of the Alltel trust property sales during the quarter had an unfavorable revenue impact of about $100 million.

During the quarter we saw revenue growth in our key areas, including Wireless data, FiOS, and strategic services within the Global Enterprise market. With that high level snapshot of revenues, let's move to the segments next, starting with Wireless on slide seven.

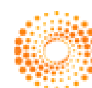
In Wireless, we had another strong quarter with sequential improvement in revenue, ARPU churn and profitability. Our revenue growth performance was strong with total service revenues up $697 million or 5.2% year over year. And when we look at our results, without the Alltel trust properties, in other words on a pro forma basis, total service revenue growth was 6.2%. Our focus on expanding the data market drove data revenue growth of 23.8% compared with last year. Total data revenues grew to $4.8 billion this quarter and comprised 34.5% of total service revenues. And total data ARPU grew 16.1% year over year.

Our strategy is focused on continuing to take advantage of the rapidly growing smartphone device category. Our approach is to support a number of different operating systems and platforms and to offer a robust lineup of devices, which gives us the opportunity to not only attract new customers but upgrade our existing customers.

In addition to improving ARPU and customer retention, we believe this approach will drive sustained data revenue growth, and we continue to be very bullish about this opportunity. For starters we see plenty of upside in terms of data penetration. At the end of the second quarter, 35% of our retail postpaid base had smartphones or multimedia devices, up from just under 31% at the end of the first quarter and 26% at year-end. 20% of our postpaid customers have smartphones and 15% have multimedia devices.

The Droid franchise has been a great success. We have had a steady stream of devices featuring the Android operating system since the first Droid was introduced last fall. To date we have six devices with multiple manufacturers in our current device lineup with more to come. The Incredible was introduced late in the second quarter, and we began selling the new Droid X on July 15. Both devices have sold very well, and customer feedback has been terrific. We have had some back order issues, but this is more timing than anything else. Customer demand and interest in the smartphone category has never been greater.





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Demand is being driven by the proliferation of new devices with greater capabilities and innovative applications and content. We feel really good about our device portfolio with great momentum going forward.

Looking ahead, particularly with the commercial launch of LTE later this year, we believe that our network advantage will become even more evident and differentiate us more than ever before. Let's now talk about our customer growth results.

We've displayed our customer activity on slide eight, so you can clearly differentiate the second-quarter net add growth from the effect of the Alltel trust property subscriber adjustments. We had a good quarter in terms of growth, adding 1.4 million net new customers with 665,000 retail postpaid net adds and 896,000 reseller additions.

In the postpaid market, we competed very well this quarter with a strong device lineup. Our increased focus on customer retention drove an excellent sequential improvement in postpaid churn of 13 basis points. Our net add performance in the reseller channel was also very good, especially since the second quarter is typically seasonally lower in this customer category.

As we have said, the reseller market is a low-cost channel for us and an effective way for us to attract incremental prepaid customers. We ended this quarter with 92.1 million customers, which, as you know, is substantially retail postpaid, representing 89% of total customers.

And, as we identified beginning last quarter, the Other Connections category is where we will be including all kinds of machine to machine devices such as vehicle tracking, telematics, eReaders, consumer electronics, smart grid solutions and medical alert devices.

Let's take a closer look at our retail performance on slide nine. Our key focus continues to be on the retail postpaid market where we continue to drive revenue growth through increased data usage and penetration. Retail service revenues grew 4.2% in the quarter. Retail postpaid ARPU increased 1.2% compared with a year ago, effectively doubling the year-over-year accretion we saw in the first quarter. This accretion is driven by data plans and the increasing percentage of customers using smartphones and multimedia devices. Device upgrades were strong once again with about 9% of our postpaid customers upgrading in the second quarter. Customers continue to respond very well to our portfolio of smartphones and multimedia devices. About 40% of device sales from our direct channels were smartphones with a $30 monthly data plan and 17% were from multimedia devices, which have a minimum $10 monthly data plan attached.

Our strategy of stimulating data revenue growth is also improving customer retention. Our churn metrics this quarter were excellent. The improvements were most notable in retail postpaid with churn under 1% and improving by 7 basis points year on year.

In terms of profitability, we had another excellent quarter, generating $6.7 billion of EBITDA, up 7.8% from a year ago. Our second-quarter service EBITDA margins expanded to 47.5%, driven by strong data revenues, churn improvement and the continued benefit of Alltel synergy savings.

Looking ahead, you can expect us to continue achieving both growth and profitability with a focus on gaining share in the retail postpaid market and increasing the penetration of smartphones and other data devices which will further expand the data market.

Let's move to our Wireline segment on slide 11. On the consumer side, our broadband and video products continue to drive a significant shift in our revenue mix. FiOS revenue in the quarter grew more than 33% year over year, and FiOS ARPU, which now exceeds $145, is up 7% over the second quarter last year. On the Enterprise side, growth in Strategic Services, which includes security, IP and other managed solutions, continued to transform the revenue mix. In Wholesale, revenues were impacted by secular pressures and the effect of some international pricing changes. Let's take a closer look at both the consumer and business markets, starting on slide 12.



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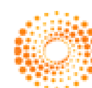

This time last year FiOS made up about one-third of consumer revenue. FiOS revenues now represent more than 43%. Within consumer, the strength of our broadband and video products, together with our increasing scale, should continue to drive positive revenue and ARPU growth and offset the secular and competitive pressures in this part of the business. Consumer revenue in the quarter grew 0.3% versus last year, and we continue to see strong growth in consumer ARPU, which increased to more than $80 this quarter, up 11.4% from a year ago.

In terms of customer growth, we saw a sequential improvement in net additions for both FiOS TV and Internet. At the end of the quarter, we had a total of 3.2 million FiOS TV customers, adding 174,000 this quarter compared with 168,000 in the first quarter. Our FiOS TV penetration is 26% based on about 12.4 million homes open for sale.

On the broadband side, we added 196,000 new FiOS Internet customers this quarter compared to 185,000 in the first quarter, bringing our total to 3.8 million. And with about 12.9 million homes open for sale, FiOS Internet penetration is 30%. Adding in high-speed Internet or DSL customers, we ended the quarter with 9.3 million broadband connections.

Let's move next to our business markets on slide 13, which shows our global Enterprise and global wholesale revenue performance.

While revenues in the business market continue to be affected by macroeconomic pressures, we are seeing some signs of stability. Global Enterprise revenue showed positive sequential and year-over-year growth, up 1.1% versus first quarter and 0.6% versus the second quarter last year. Our revenue performance was helped by strong CPE sales and network and solutions-based services. Strategic services, which represent about 40% of global Enterprise revenue, grew 6.2% year on year and 3.5% sequentially.

I would say we're seeing some signs of stabilization. We are still cautious in our optimism as usage volumes and unemployment figures have not shown any meaningful change.

In Global Wholesale, revenue declines were worse than trend, down 8.3% year over year and just under 5% sequentially. Domestically revenues continue to be impacted by secular pressures. Internationally we made a decision to increase voice pricing in certain routes, which resulted in some loss of business in this highly competitive market.

Let's cover Wireline profitability next. In the second quarter, we were able to improve the EBITDA margin by about 100 basis points sequentially to 22.7%. The improvement was primarily driven by wage-related savings and third-party interconnection costs in the quarter. We are making good progress in our workforce reduction initiative. Wireline headcount was down 3800 in the second quarter and 6100 year to date.

As I mentioned earlier, we had approximately 11,000 acceptances to our enhanced incentive offer in the East and mid-Atlantic regions. About two-thirds of these employees went off payroll in late June or early July with the remainder leaving the business later in the third and fourth quarter as we carefully manage the transition with a focus on customer service. The benefits of these actions should help our margins in the third and fourth quarters.

We are also considering additional force reductions in other locations within the telecom business. We should know more about this by the end of the third quarter.

As far as our other cost reduction initiatives, we are also making progress in real estate, network convergence, supply chain, inventory management and energy. We have a well-organized and realistic plan, and I am confident that we will capture these savings. We will also continue to be very disciplined in terms of our capital spending.

To sum up, we had a solid quarter with exceptionally strong cash flow. We will continue to focus on maximizing free cash flow, maintaining a strong balance sheet and reducing debt. Our Wireless results were solid, and in Wireline our cost reduction initiatives resulted in margin improvement. And we successfully completed our pending transactions by closing the sale of the Alltel trust markets during the quarter and divesting the access line properties to Frontier on July 1.



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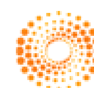

The Frontier transaction culminates a strategic transformation that we have undergone since the inception of Verizon 10 years ago. During this process we have aligned our Company with the major growth trends driving our industry. We have simplified the business by divesting our directories business, monetizing our international equity investments, and spinning off certain access line properties. We have restructured through strategic acquisitions and investments, significantly increased our exposure to the growth areas of the future, Wireless, broadband and global connectivity.

In Wireless, we have increased our scale through acquisitions, purchased valuable spectrum and invested in new technologies that will position us to capture growth in the rapidly evolving mobile broadband space. We have changed our revenue mix in Wireline, reinventing our technology base with fiber and expanding our global presence through acquisition to meet the growing demand of Enterprise customers for global connectivity. In short, we have positioned ourselves to be a stronger competitor in areas of higher growth and minimized our exposure to areas of the business that are more challenged by secular change.

The revenue pie on slide 16 highlights our current revenue mix. The first observation is that 83% of our consolidated revenues come from Wireless and global business customers.

Secondly, the Wireline mass-market business comprises only about 16% of our current revenues with a majority of our households covered by FiOS. So the net result of the strategic investments and divestitures that we made is an outstanding set of high-value assets with greater potential for revenue growth.

We are also confident that over the long term we can grow profit and shareholder returns. In the short term, I realize that the impact and timing of these divestitures make estimating 2010 earnings more difficult. So, in addition, to providing pro forma historical information soon, I would like to offer investors some thoughts about the impacts of these divestitures and my outlook for the second half of the year.

Before non-operational and one-time items, we had $1.13 of earnings per share in the first half of the year. The assets we spun off to Frontier and the Alltel trust properties accounted for approximately $0.12 of first-half earnings. So excluding these properties, we had $1.01 of earnings per share. Our goal is to grow earnings in the second half of this year by 5% to 10% from this first-half adjusted base of $1.01. In the second half of this year, we expect a continuation of the trends we are experiencing in our Wireless business. We believe we can continue to grow the business in terms of net adds and drive higher smartphone adoption, leading to accelerating ARPU accretion and revenue growth.

In addition, we will continue to make great progress managing costs. You saw the strong service EBITDA margin that we delivered in the first half, and we expect to continue this performance.

In our Wireline business, although we don't expect any significant economic driven improvements in the second half, we will continue to accelerate the success in the cost reduction programs you saw in the first half. Virtually all of the benefit associated with our incentive offer to associates will be reflected in our second-half results.

In addition, we continue to make great progress in other areas such as reducing our overall access costs and delivering on all of our other cost reduction initiatives. So, again, a good quarter. We are optimistic about the outlook for the second half of the year, and we are confident in the long-term potential of the business.

With that, I will turn it back to Ron so we can get to your questions.

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**Ron Lataille** - *Verizon - SVP, IR*

Thank you, John. Brad, if you could open up the lines for questions.



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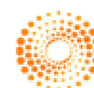

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). John Hodulik, UBS.

**John Hodulik** - *UBS - Analyst*

John, first, maybe a follow-up to some of the guidance you just gave. So if I'm doing the math right, it would suggest that on a non-pro forma basis you're talking in the 220 to 226 range for 2010 and on a pro forma basis more like 208 or 209 to 214. These are some of quick numbers, but I guess given the 5% to 10% range, is that sort of in the ballpark?

**John Killian** - *Verizon - EVP & CFO*

If you take the first-half earnings of $1.13 and then I indicated if you strip out the impact, so if you look at the Frontier contribution, that is in the range of $0.08 to $0.09 in the first half of the year. Trust properties are in the range of $0.03 to $0.04. Combined it is about $0.12. So if you strip that away, it is $1.01. What we are saying is we would grow 5% to 10% off of the $1.01.

**John Hodulik** - *UBS - Analyst*

So $1.06 to $1.11 and then you add that back to the $1.14?

**John Killian** - *Verizon - EVP & CFO*

You can do the math. You can do the math, and you can make it work. Add that to the $1.13 we had in the first half of the year and you will get to a range.

**John Hodulik** - *UBS - Analyst*

Okay. I guess my real question is around margins. Really on the Wireline side, you had some nice outperformance in the quarter. You went through some of the issues there. I know you don't have pro formas out yet for the deal, but given the progress you have made on the cost savings side, are we still expecting about a 200 basis point decline in margins, line item margins on a sequential basis, or did some of the cost savings continue to kick in and maybe offset some of that impact in the second half?

**John Killian** - *Verizon - EVP & CFO*

Yes, John, we will be putting pro formas out as we mentioned late August, early September. The initial impact, as you strip out, Frontier is around a couple of hundred basis points.

Now, as we have said on the call and we have said on past calls, within the Wireline business, we are extremely focused on driving costs out of that business. Had very strong performance in the second quarter. I had indicated on the first-quarter call that we thought that was the case.

Force benefits sequentially. We had some wage-related savings principally on the overtime side. We did not see any of the benefit really in the quarter from the 11,000 force reduction that we have got with the associate offer. So most of the individuals



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who went off in the second quarter, it was late in the quarter. We had some more in early July. That was a little over 7000 of the 11,000 that went off there. So we should see those benefits in the second half of the year.

So we believe we can improve Wireline margin in the second half of the year off of the pro forma Wireline margin that we will be putting out, and we feel good about those initiatives. Every cost line is being attacked in the Wireline business. Our third-party access costs or telco costs are a big area of focus. Obviously all the headcount items are a strong area of focus. We are seeing improvements in real estate expense. We have vacated some buildings. Most recently, we terminated the lease in Philadelphia on 1717 Arch Street, which was a fairly sizable commitment for us. So we think we have a lot of opportunity to drive cost reduction on the Wireline side.

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**Operator**

Mike McCormack, JPMorgan.

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**Mike McCormack** - *JPMorgan - Analyst*

Congratulations, Ron. As much as it might be selfish, I hope to hear you in October as well.

John, on the Wireless margin side, can you just give us some sense on what the drivers were for cost reduction? Obviously a very strong net add quarter, gross adds pretty flat sequentially. Looks like a pretty good takedown in SG&A. Is there some part of that that came out with divested properties, and what should we thinking about for a good run-rate there?

And then secondly, with the Vodafone issue looming at some point maybe next year or 2012, Wireline CapEx looks like it is down year-to-date about $1 billion year over year. How far can we get that down over the next year or so?

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**John Killian** - *Verizon - EVP & CFO*

Okay, Mike. A couple of thoughts for you. Clearly I think you can see from the call that our Wireless business is really firing on all cylinders, and we think there is substantial opportunity ahead of us to continue that performance. We are in the early innings of Wireless data with only 20% of our base having a smartphone and then with LTE a whole set of opportunities around video. So we think there is a lot of opportunity to accelerate topline performance as we go through the second half of the year and into 2011.

Now a couple of thoughts for you. The Wireless team is extremely focused on all areas of cost. If you look actually at headcount, they are down year on year about 8000 people. Now a couple of thousand of those are related to the trust properties. There is a little bit of other ones in terms of leave of absence, those kinds of things. But net net we are down 4000 to 5000 people.

They have a series of initiatives within the Wireless business that is focused on their distribution side of the business. That is driving more efficiency, more online transactions, again an area where we think we are very early in the process of driving that out.

Another area that they have a lot of attention is all of the costs and expenses around managing supply chain, inventory levels and just the whole process there. So just about every area of the Wireless side, again like Wireline, they are attacking the underlying cost structure. We are very pleased with the margin performance in the second quarter and think we're in a good position to continue to drive both growth and profitability in that business.

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**Mike McCormack** - *JPMorgan - Analyst*

Okay and on the Wireline CapEx -- (multiple speakers)

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**John Killian** - *Verizon - EVP & CFO*

On the Wireline CapEx, we indicated our guidance was $16.8 billion to $17.2 billion for the full year on CapEx. You can see in the last two quarters we have had a big shift where more of our spending is going to Wireless than Wireline. So we are taking Wireline down this year. I expect that trend to continue as we go into 2011. I think we can take another bite out of it down next year. I'm not going to size that right now because we are early in the process. But I think our overall CapEx spending as we look at 2011 will be down from where we are today, although we will keep a pretty strong allocation to the Wireless side. As you know, the Wireless side is being fueled by LTE and by data.

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**Mike McCormack** - *JPMorgan - Analyst*

Okay. And I guess, John, your comments on the Wireless SG&A side, it sounds like the bias would be towards flat to down on SG&A for the balance of the year?

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**John Killian** - *Verizon - EVP & CFO*

Very focused on driving more and more costs out of the Wireline side on SG&A, absolutely. And on the back of the 11,000 volunteers we had on our East associate offer, I should mention that we are going to do some additional offers in the rest of Verizon in the second half of the year in our what used to be the West, which is really California, Texas and Florida. So we would expect to get some additional force reductions from that.

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**Operator**

Simon Flannery, Morgan Stanley.

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**Simon Flannery** - *Morgan Stanley - Analyst*

On the dividend outlook, you have always had some strong cash flow performance. You have got a positive outlook for the second half of the year. But, on the other hand, you also distributed a dividend, which was effectively with Frontier with a lot of cash generation. So how should we think about your upcoming decision in September around continuing that annual dividend increase, or are there some sort of one-time factors this year?

And then we have had AT&T out with tiered data pricing. You have got a lot of smartphone load now. LTE is coming up. What are your current thoughts on tiered data pricing?

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**John Killian** - *Verizon - EVP & CFO*

So, Simon, just a couple of thoughts for you. Yes, cash flow is tremendously strong, better in the quarter than even we expected. The team has a tremendous amount of effort and attention there. It is driven principally from operating performance.

As part of that, though, is I hope you noticed the working capital benefits. Because the operating team is very focused on managing inventory levels and all of your days sales outstanding, all of the components that drive cash flow in the business. And I think we are performing extremely well here.



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So on the dividend, Simon, as you know, that is a board decision. The board will consider that in September. I think we put them in a position where they have some pretty good alternatives there from a dividend perspective given the cash flow performance. But at the end of the day, that will be their decision.

On pricing we are performing extremely well right now. If you look at our data revenues this quarter, they are up about 24% year on year. If you look at data ARPU for our postpaid base, they are up over 19%. Again, as I said to you earlier, a lot of upside potential there, given where we are around smartphones and multimedia devices in the future.

We have indicated in the past, as we move to an LTE world and LTE pricing, we will probably look very hard at tiered pricing, and that continues to be our thinking right now. So more to come on that. By the way, I should say that all of our efforts, all of our plans on getting LTE launched in the fourth quarter are on schedule. We feel very good about that. We think that is going to open up a whole new set of opportunities to continue to grow this Wireless business that is again performing very well.

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**Operator**

David Barden, Bank of America.

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**David Barden** - *Bank of America - Analyst*

John, just, first, could you talk a little bit about the one part of the Wireless that seemed to be maybe a little on the soft side, which was the retail prepaid. It seems like you guys have transferred the economics of being a retail prepaid provider in Wireless over to your wholesale relationship with TracFone. That relationship has been on for a year now. I was wondering if you could talk to us about your takeaways and some of the experiments you are doing with the $50 unlimited plan in the Southeast?

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**John Killian** - *Verizon - EVP & CFO*

Okay. So overall, from a growth perspective in Wireless, very satisfied, 1.4 million net adds. On the last quarter call, a lot of those, a lot of people were suggesting that the postpaid market was coming to its end, and we suggested to you that we thought there was still a lot of life there for Verizon, and we did a lot better in the second quarter than we did in the first quarter.

So we feel very good about our position in the postpaid marketplace. That is our prime strategy. The device lineup, Lowell and his team have done a tremendous job with the device lineup. The whole Droid franchise is performing extremely well. We introduced The Incredible, as you know, in the second quarter. We just launched the Droid X. There are more devices to come. So we think our handset lineup is very well positioned.

Now we have also suggested that we decided to play more of the prepaid marketplace, not exclusively. We have our own prepaid offerings that have benefits in terms of handsets and customer service, but that we were playing more of that end of the market through the reseller opportunity. By the way, not just the straight talk offering. There are several different resellers, and we have been very satisfied with that. It has fueled some nice growth for us as we have gone through the past year. The ARPU levels runs significantly higher than the traditional reseller offerings we have had. The profitability from a pure margin percentage basis is pretty good because you don't have the marketing costs and a lot of the SG&A. So we think that strategy has worked well for us, and we are continuing to do that. There is always some seasonal fluctuation there from a reseller model.

Now, on the prepaid offering that you said, it is just a trial in the South. It is targeted to a specific geographic area. There is not a plan at the moment to bring that nationally. From time to time, our areas do different things to see what kind of reactions, kind of experiment, and that is what that is all about. Nothing more than that. Okay?

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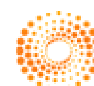

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**David Barden** - *Bank of America - Analyst*

Thanks, John. If I could just follow up on the tiered pricing also, obviously you had a good quarter in postpaid. The new iPhone and the pricing changes came out at the end of second quarter. Now that you have had some time to assess the market and what the tiered pricing plan has meant for AT&T versus you guys now without it, how compelling an offer do you feel it is? How competitively imperative is it that you do something along those lines, or is it mostly just a capacity management (inaudible)?

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**John Killian** - *Verizon - EVP & CFO*

It is very early days since that change went in. What I would tell you is is our business continues to perform extremely well. That our smartphone lineup is being very well received. Our Droid lineup we have trouble keeping the Droids in stock. By the way, we don't have a big supply problem here. There is a little bit of a delay in fulfillment, but we are in a good position there.

So our business is continuing to perform extremely well. You have not seen us rush out to make any kind of a change. We will continue to monitor the situation, of course, and look at opportunities that will say what is the best equation for us to drive long-term shareholder value, and we will be very focused on that. I cannot say enough, though, about the opportunity we see ahead given where we are today with smart phone penetration. I mean I think 20% of our base today, where is that number going ultimately? Is it 80%? Some people could argue everyone is going to have a smartphone ultimately because that is the kind of device it is going to be. So I think there is tremendous opportunity to continue to drive and create value through Verizon Wireless.

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**Operator**

Michael Rollins, Citi Investment Research.

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**Michael Rollins** - *Citi Investment Research - Analyst*

I just wanted to follow up on the cost side. I think it was the last call you started to size the opportunity for cost-cutting over the next two years. And, if I remember correctly, the comment was at least $1.5 billion to $2 billion. Based on the efforts you have made in the second quarter, can you give us an update in terms of the size of the opportunity and what percent of that you think you could realize in 2010 versus 2011?

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**John Killian** - *Verizon - EVP & CFO*

So Mike I'm not going to re-size the number for you. What I would tell you is our confidence on the ability to drive costs out of the entire business, both Wireline and on the Wireless business, too, has never been stronger. I think we have come off a quarter where we have had very good performance.

If you look at our business year on year, we are down about 24,000 people in total from an absolute basis. A big chunk of those coming out in the first half of this year, more coming out in the second half of the year. By the way, we also transferred a little over 9000 people with the Frontier transaction that we just completed.

So I think we are in a very good position. The organization knows how important it is to resize the cost structure. So we feel very confident about our ability to do that.

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**Operator**

Jason Armstrong, Goldman Sachs.



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**Jason Armstrong** - *Goldman Sachs - Analyst*

Maybe a couple of questions. First, on Enterprise trends, the results seem to indicate share shifts in your favor. I'm wondering you obviously talked about the macro, but can you talk about what you're seeing in the competitive marketplace?

And then maybe second question just on Wireless ARPU. Good progress on postpaid ARPU growth, accelerating the rate of growth after you moved up to 1.2%. But with the device refresh you have got going on, it seems like we have a lot more upside. So I'm just wondering if you can talk about the trajectory from here, and we see at least one peer in the industry approach 4% growth, do you think that is realistic for you?

**John Killian** - *Verizon - EVP & CFO*

Okay. Jason, a couple of thoughts for you. Yes, Enterprise we had better performance this quarter. On a reported basis, we were up, which was very good. Now we had a couple of things that helped us there. We had a very strong CPE quarter. A lot of demand for equipment out there, which is good. It drives some margin. We are doing some pricing change on the CPE lineup. We did it late second quarter, early third quarter to drive a little bit of margin. That might temper down the volume just a little bit as we go through the third quarter.

When you underlie and strip out CPE and some of the other things, we did see improved performance in Enterprise, although it was still a little bit negative year-over-year. We are -- I would not say we are seeing any big change from an economic standpoint at this point. I think you are hearing that from every call that is out there right now. Maybe in the first quarter there was a little bit of an uptick with everything going on in Europe and other issues, there has probably been a little bit of a pause in terms of purchase decisions right now. We are hoping that will pick back up in the second half of the year. But, from a pure Enterprise perspective, we were pleased with our performance in the quarter, but we have a little bit of caution as we go through the rest of the year and again why it is so important to drive more and more costs out of the business.

But, at the same time, very focused on driving more profitability in Enterprise. In fact, as I looked at our deals we signed in the second quarter versus the first quarter, margin was up about 250 basis points on those deals quarter to quarter. So I think that was a very good sign.

You know, from a Wireless postpaid ARPU, we think there is upside as we go through the next couple of years. Our smartphone lineup, if you think about it, over the last year, we have solved the problem with the Droid franchise where we were a little bit behind in terms of the smartphone lineup. That is paying dividends for us right now. We expect those dividends to accelerate. That our lineup is going to do extremely well.

I would love to see 3% to 4%. I think we will get better. I think the other company that you indicated they do have a higher concentration of smartphones in their customer base than we do today. But that gap is going to close. Because we have got great devices, great lineup, and, of course, our distribution is a machine quarter after quarter. So I think you are going to see improving performance there. And it just comes back to the issue I said earlier is we believe there is tremendous opportunity to continue to drive shareholder value in this business fueled principally on the Wireless side.

**Operator**

Brett Feldman, Deutsche Bank.



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**Brett Feldman** - *Deutsche Bank - Analyst*

First of all, I just want to congratulate Ron on the great opportunity and wish you well. I just wanted to go back quickly here to Wireless margins. You gave a lot of color earlier about what you're doing, particularly on the cost management side. You are coming in at an all-time record this quarter in terms of EBITDA margin. I just wanted to maybe get a bit more color around what the ultimate goal here is. Is the cost-saving initiative, is that designed to help you guys sustain what is a margin level that is maybe 200 to 300 basis points higher than normally people would have expected? Or are you really just trying to create capacity so that you can keep your foot on the gas in terms of driving data, in terms of incurring the subsidies that you would get from higher smartphone sales and maybe the higher costs you are eventually going to incur from running the LTE network?

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**John Killian** - *Verizon - EVP & CFO*

Look, I think from a Wireless perspective we have always been a very balanced company in terms of not just looking at top line, not just looking at growth, really looking at all the levers to drive shareholder value. We still are in the same place. So we are going to have a lot of focus.

And I have said this since I have been on this job, I have said I think there is opportunity to continue to grow the Wireless business very nicely, and we think growth is going to accelerate. Right? We think there is not going to be a deceleration in growth. There is actually going to be a next wave fueled by data and video where growth is going to get better. But, at the same time, we have the opportunity to take costs out of the model and become a more efficient provider. And Lowell and his team are extremely focused on that. So I like our position here from a Wireless perspective and where we have the ability to go.

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**Brett Feldman** - *Deutsche Bank - Analyst*

And I think this should be a little bit more specific. I mean you're doing a great job with smartphones. You are a little bit over half your sales in your direct channel now are smartphones rather than integrated devices. But based on your lineup, you could easily see that at 70% or 80% in the not too distant future. You are probably going to be incurring some additional costs as you get ramped on LTE. I'm just trying to set expectations here. Should we assume that at some point that might create a little bit of incremental pressure on the margins, or do you really feel comfortable that what you have done from a cost management side can keep things in a range, even as you ramp in those areas?

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**John Killian** - *Verizon - EVP & CFO*

I feel very comfortable that we can both grow the top line of the business and deliver and just continue to deliver the industry-leading profitability that we have delivered. There is no question there is going to be a higher take-up of smartphones and multimedia devices, but we are very well positioned for that. There is also a nice return from that because they are higher ARPU-based customers. So I don't think anyone's network, anyone's distribution is better positioned to take advantage and drive it to the bottom line than we are, and we are very focused on it.

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**Operator**

Tim Horan, Oppenheimer.

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**Tim Horan** - *Oppenheimer - Analyst*

Ron, good luck. John, sorry to beat a dead horse here, but one of your major competitors when they started growing out smartphones, they saw the margins get depressed quite a bit. You are not seeing that now, and it sounds like you don't expect



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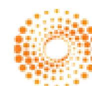

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to see that. Is it because the Droid maybe has a lot lower subsidies than the Droid lineup than some of the other high-end smartphones out there?

And secondly, could you just give us maybe a little bit more -- oh, sorry, on that point it sounds like you're saying that you are not going to see any supply chain problems with the Droid lineup in the second half of the year. Maybe just comment on that.

And then just, lastly, can you give us a bit of a regulatory update? Are you you guys talking to the FCC about ways to avoid the Title 2 regulation discussions that are ongoing? That would be helpful. Thanks.

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**John Killian** - *Verizon - EVP & CFO*

Okay. So Tim, smartphone subsidy levels, subsidy levels because smartphone devices cost you more money, our COGS is up. But we are getting -- it is a nice trade-off here. And if you look at our machine in terms of what we built over time, we have the ability to manage that and absorb it and still drive good margins, and we believe we can.

Now if we had one quarter where we had 3 million Droid net-adds, there is probably going to be a little bit of an impact. But, by the way, I would take that impact because of what it is going to do ultimately for value and shareholder value. So we are focused, as we have always said, both on growth and profitability. We will continue to be focused on that. We are taking costs out of our supply chain process, and we will continue to do that. We are managing inventory levels extremely tightly, which is appropriate.

From a supply chain perspective on supply of smartphones, we need to manage through it, which we are. These are kind of global issues with certain devices, but we are in a good position here. We think we can fulfill the requirements we have as we go through the second half of the year. We are working extremely closely with all of our manufacturers, and we think we are extremely well positioned.

The other comment I would make here, Tim, on the Washington front, yes, we are actively, actively engaged, including Ivan and Tom Tauke and Randy Milch on all of the issues, both with the policy makers, as well as other industry participants. And we will have to watch -- we will continue to watch this, and we are optimistic that this will come out in the right place for us and for the industry. But time will tell on that. So not a lot more that I could comment on there right now.

I just want to add one other thought here for you before we close off. We did complete the Frontier transaction. I know you are all anxious for pro formas. We will get that out to you. But, as we look back on that, that was a very, very good transaction for us and for Verizon. When we first announced the deal, there were about 4.8 million lines in those territories.

As you know, we had a fixed value effectively. The value per line was about $1791. By the time we completed the transaction, it was about $2,140 per line. So we are very satisfied with what we have done with the Frontier transaction. We think we have gotten very good value here for the Verizon shareholder both in terms of the value they get in Frontier and the debt relief. So it is a transaction we are very pleased with, and our team I think did an outstanding job working with Frontier on all of the transition.

I would also like to just publicly acknowledge Ron on this call. Many of you did that, but he has done a terrific job for us over the last several years. We will be announcing his replacement shortly in August, and I think it will be a top-notch individual. And, of course, that individual will have the guidance of Ron on what needs to be done here. So Ron, I would just like to thank you, and I know from the industry you will be getting a lot of thanks.

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**Ron Lataille** - *Verizon - SVP, IR*

Thank you very much, John. And Brad, that concludes our call today. Thanks, everybody, for joining us.



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**Operator**

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

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