

FINAL TRANSCRIPT

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PRESENTATION

Operator

Good morning and welcome to the Verizon third-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. John Doherty, Senior Vice President Investor Relations for Verizon.

John Doherty - Verizon - SVP, IR

Good morning and welcome to our third-quarter 2010 earnings conference call. Thanks for joining us this morning. I'm John Doherty. With me this morning is John Killian, our Chief Financial Officer, and Fran Shammo, who will be assuming the CFO role on November 1.

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.

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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.

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.

As I'm sure you are aware, we published reclassified historical financial information for the past six quarters for the results associated with the Frontier transaction, as well as the divested Wireless Trust properties.

In addition, we have reclassified prior period Wireless results with a deferred revenue adjustment that we recognized in the second quarter of 2010. The financial and operating metrics included in our slides are, therefore, presented on a comparable basis. However, on the balance sheets and statements of cash flows, prior periods were not reclassified for the impact of the divested properties.

On a GAAP basis, we reported earnings of \$0.31 per share in the third quarter. These quarterly results include a total of \$0.25 of nonoperational charges, which are listed on slide four. The largest item is a non-cash charge of \$0.19 per share relating to the recognition of pension settlement losses resulting from our workforce reduction and separation plans. Pension accounting rules require that settlement losses be recorded once prescribed payment thresholds have been reached.

In connection with the closing of the Frontier spinoff, we also incurred a charge of \$0.04 per share for certain nonoperational and transaction-related costs.

The last item is merger integration costs related to Alltel. During the third quarter, charges related to these activities amounted to \$0.02 per share.

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

John Killian - Verizon - EVP & CFO

Thanks, John, and good morning, everyone. Before we get into the details, let me start with some comments on our overall performance and add some of my perspective to our third-quarter results.

The business is performing extremely well. We had another solid quarter, and we continue to execute well in our key focus areas. We had strong earnings performance in the quarter, showing sequential improvement.

On our last conference call, I stated that our goal was to grow earnings in the second half of the year by 5% to 10% from our first-half adjusted base of \$1.01 per share. Our third-quarter results indicate that we are on track to meet this goal and expect to be at the high end of this guidance.

Wireless had a very good quarter with accelerating revenue growth driven by strong postpaid ARPU accretion. New customer additions and device upgrades once again resulted in higher smartphone sales and drove data revenue increases, and we sustained our Wireless EBITDA margin of 47.2%, which remains by far the highest in the industry.

In Wireline we continue to make steady progress. We had a very strong quarter of customer growth in FiOS with our third consecutive quarter of sequential improvement, adding more than 200,000 new customers in both TV and Internet, our highest net add totals since the second quarter of 2009. Revenues in global enterprise were stable, showing modest sequential improvement, and while the Wireline revenue picture is essentially unchanged, we were able to improve our EBITDA margin on a sequential basis, coming in more than 20 basis points higher than last quarter at 21%. We will talk more about this in a few



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minutes, but we feel confident that our workforce and other cost reduction efforts have stabilized Wireline profitability, and we should continue to see these benefits in the fourth quarter.

In terms of cash generation, we had another outstanding quarter. Our improved business performance and tight controls on capital have resulted in significant increases in free cash flow for the first nine months of the year. And our focus on reducing leverage has improved our key credit metrics and strengthened the balance sheet.

I would also highlight that our Board of Directors approved a 2.6% dividend increase in September, which on an annual basis is an increase from \$1.90 to \$1.95 a share. This marked the fourth consecutive year of dividend increases. So all-in-all we are pleased with our continued strong performance.

Let's now move to our more detailed review of the quarter, starting with some financial highlights on slide four. Reported earnings for the quarter were \$0.31 per share. The non-operational charges amounted to \$0.25, so you can see that gets us to a \$0.56 quarterly result. So we're building solid earnings momentum. I would point out that we saw about a \$0.01 EPS benefit in the third quarter due to a lower effective tax rate post the Frontier spinoff. For the full-year 2010, absent any further significant tax law changes, you should expect that the adjusted effective tax rate attributable to Verizon will be in the 31% to 32% range. Consolidated topline growth accelerated 2.1% year over year and drove an 8.3% increase in operating income. Our adjusted EBITDA margin also expanded 130 basis points to 33.4%. And cash flow continues to be very strong.

One additional point on earnings, we are seeing sequential improvement. Slide five shows our quarterly earnings on a comparable basis. So our \$0.56 per share this quarter is a 7.7% improvement over the second quarter. Let's spend a few more minutes on cash flow, dividends, capital spending and debt on slide six.

Cash flow from operations in the third quarter totaled \$8.3 billion, and free cash flow was \$4.2 billion. On a year-to-date basis, cash flow from operations of \$25.2 billion is up 9.1%, and free cash flow of \$13.4 billion is up \$2.7 billion or 25.3%.

In addition, we received \$3.1 billion in cash from the Frontier transaction in early July that we used to reduce debt, and a cash distribution of about \$440 million from Omnitel this quarter.

As I highlighted earlier, our board approved a dividend increase for the fourth consecutive year, demonstrating their confidence in the strength of our cash flow and balance sheet and our commitment to return cash to shareholders.

In addition, our shareholders received \$1.85 per share in value through the Frontier transaction in July.

I can assure you that we have adequate dividend coverage based on our cash flow and our capital spending outlook. We had no material funding requirement for our qualified pension plans in 2010. And, as is customary, we fund our other post-retirement benefit plans on a pay-as-you-go basis out of operating cash flows.

Looking at capital we spent \$4.2 billion during the third quarter, which was 4.5% less than a year ago. On a year-to-date basis, total CapEx was \$11.8 billion, 4.9% below the first nine months of last year. During the year we have effectively reallocated capital between our operating segments, reflecting growth opportunities. In Wireless, capital spending is higher than last year, driven by 4G LTE deployment and network capacity requirements. Wireless CapEx totaled \$6.2 billion year-to-date, which is an increase of \$1.1 billion or about 21%. In Wireline, capital spending is down, reflecting lower FiOS deployment capital, as planned, and our tight focus on spending to increase free cash flow. Wireline CapEx was \$5.1 billion year-to-date, a decrease of \$1.5 billion or 23%.

Looking ahead we expect that our total capital spending for the year will be at the low end or slightly below our targeted range of \$16.8 billion to \$17.2 billion for 2010.



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In terms of the balance sheet, a top priority has been to reduce leverage. We are doing very well here with net debt of \$47.8 billion at the end of the third quarter, down \$12.5 billion or 20.7% since the beginning of the year. Our net debt to adjusted EBITDA ratio has improved to about 1.4 times, and we expect to be even lower by the end of the year.

Let's take a look at our revenue trends, which are on slide seven. Our overall revenue performance is improving, and we saw an acceleration of growth in the third quarter on a comparable basis. Consolidated quarterly revenues of \$26.5 billion were up \$550 million or 2.1% from a year ago. Growth was driven by solid performance in all our strategic areas, which comprised roughly 2/3 of our total revenue. We will get into more detail at the segment level, but we saw an uptick in Wireless service revenue growth driven, of course, by strong data performance. We had a very good quarter in FiOS with year-over-year revenue growth of more than 29%, and growth in strategic enterprise services is accelerating, up nearly 7%.

With that high level summary of revenues, let's move to the segments next, starting with Wireless on slide eight.

Our Wireless business turned in another very good quarter, particularly with respect to revenue growth. Total revenue grew to \$16.3 billion in the quarter, up \$919 million or 6% year over year. And growth in total service revenue accelerated to 7.7% in the third quarter, our highest year-over-year growth rate since the second quarter of 2009. Our continued focus on expanding the market for mobile broadband drove data revenue to \$5.1 billion this quarter, up 26.3% over last year. That is more than \$1 billion of growth in just one year.

We continue to make excellent progress in terms of increasing our smart phone penetration with 23% of our retail postpaid base with these devices. We feel very good about our current portfolio of smartphones, and we've built great momentum in a short period of time with the DROID franchise. Our recent announcement to begin selling Apple iPads in our retail locations is designed to stimulate sales of our MiFi devices, which have already become quite popular with customers.

We are performing well in this very competitive marketplace, but as confident as we are about our ability to compete today, we are even more excited about the future.

Earlier this month at a CTIA event in San Francisco, Lowell McAdam announced our Phase I 4G LTE launch locations. Our plan is to cover more than 110 million pops in 38 major metropolitan areas and 62 airports by the end of this year. The next phase will expand coverage to about 200 million pops over the next 18 months. By the end of 2013, we will have virtually the same nationwide coverage we have today on 3G. With Wireless data revenue exceeding \$5 billion this quarter, it is hard to believe that we are still in the early innings in terms of this revenue growth opportunity but we are. We are very excited about mobile broadband, and we believe the growing interest in smartphones, tablets and other devices signals a new wave of growth for the industry. With the commercial launch of LTE just around the corner, we are extremely well-positioned in this expanding market. We firmly believe that our network advantage will become even more of a differentiator for Verizon, given the consistent and substantial investment in our Wireless network over many years.

Let's now turn to our customer and connection results on slide nine. We had a solid quarter of growth, adding about 1 million net new customers and about 250,000 other connections. In the retail postpaid market, we had 584,000 net adds and a strong quarter in terms of device sales. Retail postpaid gross adds in the quarter were up 9.8% sequentially, and device upgrades were also higher. Our performance in the reseller channel was also very good with 550,000 net adds this quarter. As we've said before, the reseller market continues to be a low-cost channel for us and an effective way for us to attract incremental prepaid customers. We ended the quarter with 93.2 million total customers with 88% of the base being retail postpaid, 5% retail prepaid and 7% reseller. In terms of other connections, we had a total of 7.9 million machine to machine connections, which include vehicle tracking and telematics.

Let's take a closer look at our retail performance on slide 10.

As you know, our key focus is on the retail postpaid market where we continue to drive revenue growth by increasing data usage and driving higher smartphone penetration. Retail service revenues in the quarter grew 5% year over year. Retail postpaid



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ARPU increased 2% compared with the year ago, sharply higher than the year over year accretion we saw in each of the first two quarters of this year.

As I mentioned a moment ago, we had another strong quarter of overall device sales of about 9.5% of our existing postpaid customers upgrading to a newer device, our highest level since the fourth quarter last year. Our churn metrics, although a bit higher than the second quarter due to seasonality, were excellent once again this quarter. Retail postpaid churn was 1.07%, and total churn was 1.36%.

In terms of smartphones sales, we now have 23% of our retail postpaid base with these devices. That is up substantially from last year, and there is plenty of headroom left. About 43% of device sales from our direct channels this quarter were smartphones, taking into account both gross adds and upgrades, and 60% of our existing postpaid customers buying smartphones were new to the category. So this is significant in terms of incremental data revenue for us.

Revenue from Web and e-mail services increased to more than \$2.7 billion this quarter, up about 43% from a year ago. Messaging, which makes up about 36% of data revenue, is still showing good growth, up 11% on a year-over-year basis. And we have made rapid progress in a relatively short period of time adding 8.4 million smartphones customers and increasing data ARPU by 17.6% in the past 12 months. We believe penetration and data ARPU growth could really explode over the next several years, particularly in light of the growth opportunities in front of us with LTE.

In terms of profitability, we had another excellent quarter, generating \$6.7 billion of EBITDA, up 11.4% from a year ago. Our third-quarter service EBITDA margin was 47.2%, driven by strong data revenues, churn improvement and the continued benefit of Alltel synergies.

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 drive continued data revenue growth.

Let's move to our Wireline segment on slide 13. 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 29.2% year over year, and FiOS ARPU, which now exceeds \$146, is up more than 6% over the third quarter last year. On the enterprise side, we had our second consecutive quarter of sequential revenue improvement, and growth in strategic services, which include security, IP and other managed solutions, continues to transform the revenue mix. In global wholesale, revenues continue to be impacted by the effect of some international price changes on specific routes, which were introduced last quarter to better manage margins.

Let's take a closer look at the consumer and business markets, starting on slide 14.

This time last year FiOS made up about 40% of consumer revenue. At the end of the third quarter, it was up to 50%. The increasing scale of FiOS and the strength of the broadband and video product is driving positive revenue and ARPU growth and mitigating the secular and competitive pressures in this part of the business. Consumer revenue in the quarter grew 1.1% versus last year. We continue to see strong growth in consumer ARPU, which increased to \$86.55 this quarter, up 10.9% from a year ago.

As I said earlier, we had strong sequential customer growth, adding about 19% more FiOS customers this quarter to our TV services and about 17% more to our Internet product compared with last quarter. We ended the third quarter with a total of 3.3 million FiOS TV customers, adding 204,000 compared with the 172,000 in the second quarter.

On the broadband side, we added 226,000 new FiOS Internet customers compared with 193,000 last quarter, bringing our total to 3.9 million. Adding in high speed Internet or DSL customers, we ended the quarter with a total of 8.3 million broadband connections. Underlying the strong performance is the fact that our FiOS customer satisfaction is very high and our churn rates are very low. So we are pleased with the progress we are making with FiOS financially, operationally and competitively.



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The good news about our success in penetration increases this quarter is that the improvements are evident throughout our entire FiOS footprint. Our focus has shifted from a geographic expansion mode to a focus on sales mode. Our goal is to increase FiOS penetration in markets where the service is already available and close the gap between homes passed and homes open for sale. The launch of our nationwide, no contract required, worry free guarantee has helped sales, particularly in the MDU market where apartment dwellers in large urban cities tend to be more transient and may be more hesitant to sign two-year contracts. And we focused our marketing message to emphasize our product differentiation. This focus on sales and increasing penetration is paying off. In our more mature FiOS markets, we are still seeing consistent penetration gains. Penetration in some of these markets is in excess of 35%, and a few are in excess of 40% penetration.

As you would expect, in our less mature markets, we have significantly more room to grow. So we are optimistic about our ability to further increase penetration and continue our growth path over the next several years.

Let's move next to our business markets on slide 16, which shows our global enterprise and global wholesale revenue performance. While revenues in the business market continued to be affected by macroeconomic pressures, we are seeing some signs of stability. Global enterprise revenue of \$3.9 billion was up modestly on a sequential basis and down 0.8% year over year, primarily due to foreign currency effects. And while the quarter once again included strong CPE sales, we also saw improvements in revenue from network and solutions-based services. Strategic services, which now represent about 43% of global enterprise revenue, grew 6.9% year over year and 3.1% sequentially. Strategic networking like private IP and ethernet services continue to show steady growth as do strategic solutions. So, again, we are seeing some signs of stabilization, but we're still cautious in our optimism as usage volumes and unemployment figures have not shown any significant change.

In global wholesale, revenues declined 10.2% year over year and 1.3% sequentially. Domestically, voice revenues continue to be impacted by secular pressures and lower usage volumes. Internationally we made a decision earlier this year to increase voice pricing in certain routes, which has resulted in some loss of business in this highly competitive market. While the strategy has resulted in revenue declines, it is having the desired effect as absolute margins on those routes have improved sequentially.

Let's cover Wireline profitability next. In the third quarter, EBITDA increased by \$31 million, resulting in a more than 20 basis points sequential improvement in our EBITDA margin to 21%. With total revenue remaining essentially flat sequentially, almost all of the improvement this quarter was once again driven by cost reductions, primarily wage-related savings and third-party interconnection costs. Our workforce reduction initiative is proceeding as planned. Wireline headcount was down 5900 this quarter and has declined by about 10,500 over the past two quarters. As you know, a majority of these reductions relate to our voluntary separation offer in the East and mid-Atlantic regions. With about another 1000 volunteers in other regions, we expect another 2000 to 3000 employees will leave our payroll by the end of the year.

In terms of workforce reductions in the third quarter, we estimate the savings to be about \$80 million. Partially offsetting these cost savings this quarter were acquisition costs related to higher FiOS customer volumes and some typical seasonal increases, including higher energy costs.

Lastly, in terms of our other cost reduction initiatives, we are focused on capturing additional savings in real estate, network convergence, supply chain and inventory management. We have a well organized and realistic plan, and we are confident in our execution strategy.

To sum up, we had another very solid quarter across the entire business, resulting in improved earnings and solid momentum. To reiterate we are on track to achieve our goal of growing earnings in the second half of this year by 5% to 10% from our first-half adjusted base of \$1.01 per share. Our Wireless results were solid across-the-board. We remain confident in our ability to grow the business by adding new customers and driving higher smartphone adoption, leading to higher postpaid ARPU and improved revenue growth. And with our demonstrated ability to manage our costs, we continue to grow profitability, sustaining a very strong service EBITDA margin, even with higher volumes and more upgrades than last quarter.



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In our Wireline business, even though we are not getting any help from the economy and we don't expect to for the rest of this year, our cost reduction programs have stabilized Wireline profitability, and we are optimistic about our opportunities to expand margins going forward. As always, we will continue to focus on maximizing free cash flow, maintaining a strong balance sheet and reducing debt.

We are excited about our opportunities relating to the launch of 4G LTE services in Wireless, and we are certainly very confident in the long term potential of the business.

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

John Doherty - Verizon - SVP, IR

Thank you, John. Brad, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs - Analyst

A couple of questions, maybe first on Wireless ARPU. This is the fourth quarter we have seen accelerating postpaid ARPU growth, and just thinking through the increases in smartphone penetration would seem to really give you a good runway for further improvements in the rate of ARPU growth from here. I'm just wondering is that how you would think about it as well?

And the second question on FiOS, good uptick in both FiOS video and data adds. When thinking about the increase, can you just help us think through is this attached to seasonal, is it the no contract moves that you have made? Ultimately what I think we are trying to get to, is this kind of a new level that we should use as a run rate going forward?

John Killian - Verizon - EVP & CFO

I will take the first part of the question on ARPU, and then Fran will cover the FiOS performance.

Yes, we are very pleased with what is happening with ARPU. When you look at our postpaid ARPU this quarter, we were up 2% in the third quarter. If you look back at the last four quarters, fourth-quarter '09 we were flat. We went to 0.6%. In the first quarter, we went to 1.5%. You know, a theme that I have had on these calls is we believe there is a lot of upside ahead of us, and we have great ability to grow postpaid ARPU because of the explosion in smartphones. We have put a lot of energy -- Lowell McAdam, John Stratton, Dan Mead, their team -- on enhancing our smartphone portfolio. We have had great success over the last year with the DROID franchise and the BlackBerry lineup and others, but we are in a much better position.

But the good news here is only 23% of our customers today has a smartphone. That is up from 20% last quarter. So you think about this, I don't know where it is going to end up, but personally I think we're going to look some day back and say, 70% to 80% of your customers are going to have smartphones. So we think there is tremendous opportunity here, and you know better than I do smartphone customers spend about double what a feature phone customer spends with you.

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We also believe, even on the feature phone side, more and more customers will buy from data plans over time even before. As they are getting used to data on the Wireless side, they will start with a plan on a feature phone. So we think there is tremendous opportunity here to grow topline in the Wireless business, and you can see that coming through and accelerating revenue growth in the Wireless business.

Fran, I will turn to you on FiOS.

Fran Shammo - Verizon - President & CEO, Verizon Business & Verizon Telecom

Okay. Thank you, John. So to talk about the FiOS adds and the broadband adds, we are very pleased with the strong performance that we had this quarter. If you look at some of the questions you asked on the no contract, as John has spoken in the past, in the MDU space, we were underpenetrated there. We have made a lot of moves, including the no contract, but we also made a move on the contract where we offer a worry free guarantee similar to the Wireless side of the house. That if you are not totally satisfied, we will let you out of the contract with no early termination fee.

We also have launched what we call a triple play in the MDU space, understanding that a lot of this space is the younger adult segment, which, if you look at the triple play that we have launched, it is broadband, it is TV, and it is Wireless rather than a Wireline connection. So we found that that is also stimulating some growth in the MDU segment.

When you expand that, the no contract definitely has had a very good growth perspective for us, but we have also launched something new in our enterprise space where we're going to our enterprise customers, and very similar to what we do on the Wireless side with employee liable accounts, we are signing up enterprise customers to promote our FiOS product within their employee base. So that has also stimulated some growth for us.

So to wrap this up, yes, we feel that this level of adds is where we want to continue to be.

Operator

John Hodulik, UBS.

John Hodulik - UBS - Analyst

Just a couple of quick ones. First, on the Wireless data pricing strategy, you guys recently made some changes or there were some in the press. I guess I was surprised that you left the unlimited data plan out there. Is that a part of your strategy to increase the penetration of smartphones? And is that pricing essentially subject to change once we move to 4G and you potentially see data volumes grow?

And then secondly, on the Wireline margins, it seems like you may have arrested the decline, and you're starting to see some improvement. It sounds like fourth quarter you see some sequential improvement, and then is that something we can see improved from here as we head out into -- is there enough cost-cutting opportunity for us to see improvements into 2011?

John Killian - Verizon - EVP & CFO

Again, I will take the first part of this question, and then Fran will talk about the Wireline margins.

So I think what you're referring to is some of the blog reports and some of the newspaper stories. We have not formally announced any change in data pricing, but we will be rolling out a data promotion next week focused on the fourth quarter.

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As we think about data pricing here and just to give you little things to think about as we position this for the future, our aim here is really at expanding the market opportunity. We think there is a huge opportunity to continue to grow. We have a \$20 billion annual Wireless data business, \$5 billion a quarter. It is hard to describe that as early innings, but we still believe it is the early innings of the data explosion.

So we are very focused at looking at opportunities to expand this opportunity, bring more of our base into data plans.

The other thing to think about here is we believe we have built over time, because of what we have done both with network investment, our advertising programs, a superior brand position, that allows us to be unique in how we approach the marketplace from a data pricing. Unique from what other companies do because of the brand position that we have built over time.

Our fourth-quarter promotion that we will have will have really two key elements. We will continue to have an unlimited plan, the \$29 plan, that \$30 plan effectively that is unlimited. But we will also have a \$15 plan, and with the \$15 plan, you will be able to get 150 Mb of usage. But what we believe is that people who are new to this category will probably buy the \$15 plan, but over time you will see much more migration to the higher-end because there will be a lot of usage that will drive above the 150 Mb. So we think we are in a very good position.

We have said in the past, John, that we are encouraged by tiered pricing. We like the concept of tiered pricing. You could interpret this a little bit as a move in that direction, although we had the \$9.99 plan before. But we will continue to look at this and we probably will have some pricing changes when we roll out 4G and 4G pricing. So there will be more to come then.

Fran will now talk about the Wireline margin.

Fran Shammo - Verizon - President & CEO, Verizon Business & Verizon Telecom

So on the Wireline margin, as John has spoken in the past, we do believe we have stabilized. We do believe that we can continue to expand the margin in Wireline business. I would say that this is a two-pronged strategy. One is obviously topline growth, and I think it is important to note that we have reached an inflection point this quarter where FiOS is now 50% of our consumer revenue. So, as we continue to improve the consumer ARPU 10% this quarter year over year, that will drive bottom-line growth.

I think it is also important to state that on the enterprise side we have seen stabilization. However, outside the United States in our global markets, we are seeing double-digit growth, especially in the AsiaPac region and some other parts of the world. So, again, that is more topline.

But as we get into the cost and productivity and sustainability, as John has spoken in the past, we had an incentive offer for our associates. We had 12,000 associates accept that offer. About 80% of them have left the payroll to date. We will do more of that in the fourth quarter.

But it's also important to know that as we attack the cost side of the Wireline business, it is more than just the headcount reductions. It is quarter to quarter improvement in our operating metrics, especially when you look at FiOS and our cost to connect premise and our cost to connect video. If you look at our COA, our COA alone, year over year has gone down 19%, and with that reduction, we have increased our adds.

So it's a whole program of cost reduction. I believe it is sustainable. And while we are doing that, we are improving our productivity so that when the economy and the enterprise restores and we continue on the track that we are in FiOS, we will continue to produce more margin.



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Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - Morgan Stanley - Analyst

John, it was a pleasure working with you. I wish you all the best for your retirement.

You touched on the LTE introduction. Could you help us understand what other impacts there might be in terms of expense recognition or interest capitalization? Anything around that. As you roll out the LTE from the 110 into the 200 million plus, are we at a sort of steady state level here on Wireless CapEx where you are at a run-rate, or could there be sort of a reduction or a lower intensity in 2011 as the heavy lifting for that first 38 markets has already been done?

John Killian - Verizon - EVP & CFO

Yes. So I think we are very pleased with where we are in terms of the LTE deployment. We mentioned getting to 110 million POPs by the end of this year. I talked to Tony Melone as recently as yesterday to get an update on status and all systems are go.

You know, the network will be in extremely good shape. From a normal customer acquisition and maintenance and those kind of things, I think you are going to see the same kind of run rates looking ahead as you have seen as we have gone through this year. I don't think you're going to see a major delta at all. In fact, we would argue over time that there will be more efficient saving driven by LTE because the cost of megabits served is much lower with LTE than it is with EV-DO and other technologies. So we think that will position us well.

There will be some impact from -- we have been capitalizing some interest. It is not a huge number, but we will see some impact as we go into 2011. Maybe a little bit in the fourth quarter, but not a major delta there.

From a CapEx perspective, what I would think about here and on this call we have said we are going to come in at the low end of our range or slightly below. I think we have a good chance of being slightly below our guidance range on CapEx. You should think about Wireless probably at about the same level next year as it is running this year in that kind of a range. When you look this year, all of the increase we have had really has been for the most part both on LTE, as well as capacity for data. There have been other offsets. Things like synergy capital will be going down. So I think it will be a very controllable level of Wireless CapEx.

The nice thing here is the CapEx to revenue ratio in the Wireless business runs quite a bit lower than the Wireline business, and there is a lot of efficiency from that capital. So I think our cash flow numbers should continue to be strong.

Operator

Michael Rollins, Citi Investment Research.

Michael Rollins - Citi Investment Research - Analyst

Just to follow-up on that, more specifically on the Wireline side, how should we think about capital going into next year as the pace of new FiOS homes past continues to slow?

And then coming back on the Wireless side, I noticed the replacement rate was around 9.5%. And, as smartphones become a larger part of your base and then hence a larger percent of the replacement volumes, how should we be thinking about the incremental costs related to that? And are there areas that you can identify to maybe offset some of that upward pressure from just a greater pace of smartphone replacements over time?



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John Killian - Verizon - EVP & CFO

Okay. So a couple of thoughts for you here. We're not in a position yet to give any guidance on CapEx for next year. But, as I think about this and certainly Fran will be talking about this in January, I think the direction of overall CapEx spending -- and we have said this in the past -- is down from where we are today. I'm not going to quantify that exactly, but if you think about Wireless continuing to run next year at about the same level, I think Wireline will come down. We are coming towards the end of the FiOS buildout. So directionally I think overall CapEx spending will come down in 2011 from 2010.

I think we had tremendous discipline within the business around all of our CapEx spending, not only on core network but on systems and supporting infrastructure. We have also gotten much more efficient. A portion of our CapEx is labor. It is not just material, and we've gotten more efficient with that. So I think we are in a good position to continue posting very strong cash numbers and free cash flow numbers.

Now on the upgrade level, we are very pleased with the upgrade level, that 9.5% of our base upgraded in the quarter. Upgrades are a key focus for us, and as I think about it, upgrades right now are all good and will be all good for quite a while to come because a lot of times it is a feature phone customer going to a smartphone customer. I'm willing to take that equipment cost and that subsidy when I'm getting 2X the revenue.

So it is not an issue that we are concerned about. We see it much more as an opportunity in providing upside to us in terms of revenue growth and profitability.

Operator

David Barden, Bank of America/Merrill Lynch.

David Barden - Bank of America/Merrill Lynch - Analyst

Just two more if I could on FiOS and beat the horse a little bit, John. But when we have been talking about FiOS winding down, there has been a very specific number that we would save about \$2 billion a year in Wireline CapEx. And I guess it sounds like maybe you are already starting to realize some of that as you have been winding that down maybe sooner than expected. So could you put more specific numbers around as this thing comes to an end in 2010 what the dollar savings should be from that project relative to the \$2 billion you guys have been talking about for a couple of years?

And then the second part is, now that FiOS is 60% of the footprint and 50% of the revenue of the Wireline unit, could you give us more color about what are the margins now on this business, and how does its growth either benefit or dilute Wireline margins as we model that out into the next couple of years?

John Killian - Verizon - EVP & CFO

Okay. So let me hit a couple of things here. We have said in the couple of billion dollar range. We are realizing some of that this year because we had been building at a 2 million premises passed roughly, and we're going to build roughly 1 million this year.

So in our program this year, we have seen some benefit there. We will continue to see that as we go into 2011 and 2012. But the message here is I think we have become more efficient with the capital spend. Our cost per home passed has been very good. We are very pleased with that, and I think overall I think the direction of CapEx spend will be down as we go into next year.



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From a margin perspective, we are very pleased with where we are. FiOS overall we are very pleased with. We are operating income positive here. We continued to grow that. This quarter because we ramped up and had more net adds than we had had in previous quarters that had some impact in terms of the ability to expand the margin in this particular quarter. It is overall accretive to the margins of the overall business. We don't put out specific numbers, and we are not going to do that right now.

But the good news here is we accelerate at penetration. With the changes Fran has really led putting in place, we feel we are in a better position from an acquisition standpoint. There is a lot more buzz around the FiOS capability and the quality of video vis-a-vis our competition. So we think we are very well positioned, and FiOS is continuing to do well.

David Barden - Bank of America/Merrill Lynch - Analyst

If I could just have one follow-up, John. Is that 50% of the revenues in the Wireline business, is the margins in that higher or lower than the reported margins for the unit?

John Killian - Verizon - EVP & CFO

It is higher than the reported margins.

Operator

Brett Feldman, Deutsche Bank.

Brett Feldman - Deutsche Bank - Analyst

You got a question earlier about how you are seeing this ramp in smartphone adoption, yet we are still seeing really strong Wireless margins. And I think that that had been surprising to a lot of people in that the adoption of smartphones had kind of compressed margins in a lot of other operators first because you take subsidies up front and then you start getting a lot of these network abusers who are using more than what they are really paying for under an unlimited plan.

So I guess the question here is, what could cause your margins to take a step backwards as we continue to scale in the data world? Could it be an investment you would be willing to make in a new device category? Is there something incremental you would want to do on the network side that you have not done yet or really sort of sketched out for us yet? Or do you think that you can continue to run at these record levels of EBITDA margins even as you see accelerated usage of your data services?

John Killian - Verizon - EVP & CFO

I have to thank you because you have not broken the record that I have had on every call, a question very much like this. Good question, but the question going to sustainability of our margins in the Wireless business, and as you know, we are very pleased. Lowell McAdam, who is our new President and Chief Operating Officer, likes to describe us as an "and" company, not an "or" company. So it is both growth and profitability, and we have always said that. The 47.2% is 157 basis points up year on year. It is comparable sequentially. We believe it really reflects the superior execution and scale advantage that our Wireless team has built over several years. We have built tremendous scale in that particular business. We are able to absorb more subsidy and continue to do really a very strong job on margin.

Now a couple of points here I would make is, this is not a one trick pony result. If you look at revenue, we have a very nice improving revenue trend in the Wireless business. Service revenue in the fourth quarter was up 5%, first quarter 5.8%, second quarter 6.3%, third quarter 7.7%. And that is only with 23% of our customers having smartphones today.

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So we believe, as we go to the next several years and we go up that smartphone adoption, we are going to be able to grow revenue, grow profitability. We think our network is very well positioned for the growth in data traffic. We put tremendous time and focus on this with Lowell and Dan Mead and Tony Melone on making sure we are well equipped. Our assumptions assume that our handset lineup that we think is very strong today where we put all the emphasis on again the DROID franchise -- and the DROID franchise is unique to Verizon -- positions us very well, and our handset lineup we will get better over time. It is not going to take a step backwards. It will continue to be enhanced.

And is it possible we have a quarter where there is a knockout device that has some impact on margins? There is always a possibility of that happening. We have acknowledged that in the past, and that would be a good thing to have happen because of what you would do from a smartphone adoption in your overall ARPU.

Now the other part of this is our Wireless team, not only focused on net adds and growth in ARPU, but tremendous focus on driving efficiency in the business. They have been working on driving costs out of the supply chain. You have seen the tremendous results they have had this year on lowering their inventory level at a time you have new product introductions, focused on driving cost out of customer service, driving more online interactions, eliminating things like other charges and credits, OCCs, controlling them, retail store efficiency. So we think the scale we have built in that business allows us to continue to have the lead in the industry on margins, and we are not going to give that up.

Operator

Tim Horan, Oppenheimer.

Tim Horan - Oppenheimer - Analyst

John, what do you think revenue growth can do over the next couple of years? You have obviously been accelerating up. Do you see the business as kind of a 3%, 4% revenue grower? And maybe related to that, how much did your wholesale pricing changes impact revenue in the quarter? And I have a brief follow-up if you don't mind.

John Killian - Verizon - EVP & CFO

Generally I absolutely think we can accelerate revenue growth from where we are today. I mean I think the Wireless business on a service ARPU at 7% can get up into high single digits and can touch 10% with data growth. The Wireline revenue picture looks a little worse this quarter than it really is. We posted a number of 3.6%, but the major driver on that of going a little bit worse from last quarter was we made some price changes in our international wholesale business because we had certain routes out in the world that really were not driving profitability.

So when you look at our international wholesale revenue, it was down year over year by 28%. If you strip that out, our Wireline revenue was only down 2.4% versus the 3.6% that we reported. And then, as you cut under that, consumer is growing at the rate of 1.1%. We saw a better performance on small business. Our enterprise revenue, while it was negative 0.8%, if you break FX out, it was flat. So the underlying trends, even in the Wireline business, are better than we think the 3.6% number would show. And I think we believe we can get the Wireline business over the next couple of years with some help from the economy to flat and maybe to slightly growing. And if we do that, that would be very important for the business overall because Fran has talked about, there is no question we still have a lot of ability to drive more and more costs out. But we've got to get that business growing again, and we are very focused on that and we think we can. But the Wireless business there is going to be tremendous opportunity to continue to accelerate revenue growth in that business.



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Tim Horan - *Oppenheimer - Analyst*

John, just on your Wireless business, you clearly have a premium network out there. Do you think when you get the iPhone you can charge a premium price either for the device or for the service or some kind of application sharing? I'm not asking when you are getting the iPhone, but clearly there would be a huge benefit for subscribers being on your network versus your competitor.

John Killian - *Verizon - EVP & CFO*

I talked earlier about how we think about pricing. So we are very focused on the device lineup we have today. We think we have a great device lineup. You know the DROID franchise has gone from nothing a year ago to where it really has a buzz and a lot of momentum out in the marketplace right now.

From a pricing perspective, we think the brand that we have built puts us in a unique position from a pricing perspective. We have always been a bit at a premium, and we think the brand will allow us to continue to do that.

Operator

Chris Larsen, Piper Jaffray.

Chris Larsen - *Piper Jaffray - Analyst*

A question back to FiOS. You obviously picked up some share, or it appears based on what the cable companies have said that you picked up some share both on video and on data.

My question is really there has been a lot of back and forth there. Have you begun to see anything so far in the fourth quarter that indicates that cable companies are getting more aggressive either on their video or the data pricing?

And then additionally, there were some comments made actually in the New York Post recently that cable was considering a massive increase or a material increase in their high-speed data prices to offset some of this over-the-top video that may be going on. If cable were to do that, is that something you guys would follow along with, that is a large increase or material increase in your data pricing?

John Killian - *Verizon - EVP & CFO*

I think Chris, a couple of thoughts here. The FiOS video business and Internet business we have always said every quarter, is a very competitive business out there. I would not say we have seen anything recently that changes the competitive landscape from an offer or a price perspective. With the changes that Fran has led for us on the worry free guarantee, the no contract, the focus on the MDU, we think we're in a very good position.

We have not planned any price changes here at this point in time. We would always continue to look at what is happening in the competitive landscape. We think our FiOS offering based on the fiber end-to-end is a superior offering from a quality standpoint, and we have been focused very much on acquisition and getting people to move. So we would continue to evaluate that and look at what the opportunity is to accelerate revenue growth.

Operator

James Ratcliffe, Barclays Capital.

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James Ratcliffe - Barclays Capital - Analyst

Good morning, guys. Thanks for taking the question. Two if I could, one on capital structure and the other on FiOS.

On the FiOS side for broadband, where are the adds coming from? I know a material portion in the past have been people being switched from DSL to FiOS. Is that continuing? And is the mix changing in terms of DSL switches versus people coming presumably over from cable?

And secondly, on the capital structure side, if you are looking at dividend and cash up from Verizon Wireless, how much of a buffer do you have in terms of realized and tax proportional profits of Verizon Communication that have not actually represented cash dividends up from Verizon Wireless? So, in other words, how much could you dividend up from VZW before you started to actually have to pay tax, incremental tax, on those payments?

John Killian - Verizon - EVP & CFO

I'm not -- let me just start with the capital structure issue is that we are very pleased with our cash performance. We think the Wireless business, you can see it is a cash machine. The cash generation of that business is not going to decelerate. If anything, it is going to accelerate. We are in a very good position from that perspective. We believe the Verizon dividend is extremely safe. There is not a major tax issue here that I am worried about that is going to have some impact on this. So we think we are in a good position.

Fran and his team has had a lot of focus on trying to make the Wireline business more free cash flow positive. We will continue to work at that, but our cash flow margin is in a very good position, and you can see it from this quarter. Fran will comment on the FiOS question.

Fran Shammo - Verizon - President & CEO, Verizon Business & Verizon Telecom

So on the migration question, yes, we continue to migrate some of our former DSL customers into the FiOS broadband. But if you look at our net adds after you take the Internet net adds from our FiOS product less our DSL, we are still on a positive take share perspective.

The other thing to consider, too, is that when you look at the penetration of our Internet at 31 and our TV at 27, what we find is once we convert someone over to our FiOS Internet product with the speeds that we have and the amazement that they get from that, it is very easy for us to then walk in behind that and convert over to TV because we can bundle it and save them money. So I think that we do have migration from DSL, but we are also taking share.

John Killian - Verizon - EVP & CFO

Okay. Thank you, Fran, and thank you, James, for that question.

Just a couple of things in wrap up here. I hope you can see that we feel very positive about the performance of the business this quarter. You know we had given you some direction that we felt we needed to do about where earnings would be in the second half of the year. And in this quarter, we are at the very high end of that range. That is our focus for the fourth quarter. We will continue to deliver in the fourth quarter the kinds of things we delivered here. Strong Wireless results driven by continuing ARPU acceleration and stronger smartphone results. We have stabilized the Wireline business from a margin position. We have actually expanded them slightly in this quarter. We believe that will accelerate as we get into the fourth quarter, and our cash flow position is very strong and will remain very strong.



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So I thank you for taking the time. I will pass back to John just to close up the call.

John Doherty - Verizon - SVP, IR

Brad, that concludes our call today. Thanks to everyone for joining us.

Operator

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

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