

# FINAL TRANSCRIPT

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## VZ - Q1 2011 Verizon Earnings Conference Call

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*Verizon - SVP of IR*

**Fran Shammo**  
*Verizon - EVP and CFO*

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## PRESENTATION

### Operator

Good morning and welcome to the Verizon first-quarter 2011 earnings conference call. At this time, all participants have been placed in a listen only mode, and the floor will be open for questions following the presentation. (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.

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**John Doherty** - *Verizon - SVP of IR*

Thanks, Brad. Good morning and welcome to our first-quarter 2011 earnings conference call. Thanks for joining us this morning. I'm John Doherty. With me this morning is Fran Shammo, our Chief Financial Officer.

Before we get started, let me remind you that our earnings release, financial and operating information, the investor quarterly 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.

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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.

Before we get started, I would like to draw your attention to a newly formatted financial and operating information file that we've made available to you on our website. In addition to providing two years and eight quarters of historical financial information, we've added some new customer and connection metrics in wireless and wireline which better reflect the trends in our business.

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

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**Fran Shammo** - Verizon - EVP and CFO

Thank you, John, and good morning, everyone. At our investor meeting in late January, we talked about our 2011 priorities, our strong focus on business plan execution and translating revenue opportunities into profitable growth and share-owner value.

In looking at our first-quarter results, I would say we are off to a very strong start. Our wireless business performed extremely well, further solidifying our leadership position in the industry. Our 4G LTE network deployment is going very well, and our network performance has exceeded even our own very high expectations. In one independent test after another, our network's ability to deliver video and data with exceptional speed and performance has been unmatched.

Possibly even more impressive is the speed with which products and services are being developed for LTE. Through our LTE rollout, we have positioned ourselves on the leading edge of a whole new phase of wireless market development.

Our first-quarter wireless results once again demonstrate our ability to effectively manage growth and sustain profitability. We had a very strong quarter of device sales with 906,000 retail postpaid customer net additions. In a period of less than eight weeks, we activated 2.2 million iPhones, and in two weeks, we activated more than 260,000 of our first 4G LTE smartphone, the HTC ThunderBolt, at the premium price of \$249.99.

In addition, we added about 250,000 4G Internet devices to our retail postpaid base in the quarter and quickly sold out of iPad 2 tablets in early March, so we built good momentum throughout the quarter.

Our wireless service EBITDA margin of 43.7% is a solid result; and once again demonstrates our ability to effectively manage the customer acquisition and retention costs associated with gaining market share and increasing smartphone penetration while sustaining our industry-leading profitable growth profile going forward.

In wireline, our first-quarter results showed continued improvement on the top line, with sequential EBITDA margin expansion for the fourth consecutive quarter. Our improved year-over-year performance was driven by continued strength in FiOS and lower line loss rates, resulting in consumer revenue growth of 1.9%, as well as accelerated growth of 12.8% in enterprise strategic services revenue.

In terms of cost management, while the first quarter has some seasonal pressures, we did realize the cost benefits of our 16,000 workforce reductions from last year.

On the strategic front, we closed the Terremark acquisition on April 11, and significantly improved our competitive position in the rapidly evolving managed hosting and cloud services space.



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With these highlights as a backdrop, let's begin a more detailed review of the quarter on slide 4, starting with a look at consolidated results.

Consolidated revenue growth in the first quarter accelerated to 5.3% year over year, up sharply from 2.3% growth in the fourth quarter. Total revenue growth in wireless increased to 10.2%. And while much of this growth was driven by equipment sales in this quarter, we do expect to see future benefit from these sales in subsequent quarters in terms of higher recurring revenue streams.

So, top-line growth is what we expected, and we were on track to meet our full-year revenue guidance of between 4% and 8% annual growth. Our consolidated EBITDA for the first quarter totaled \$8.5 billion, up 3.8% year over year.

The 31.4% EBITDA margin is down about 50 basis points from a year ago, primarily the result of a higher acquisition, and retention costs, in wireless. Again, our expectation is for solid margin performance throughout the year, with some fluctuation in quarters featuring highly successful new device launches.

In terms of earnings, we reported \$0.51 for the quarter without any non-operational or special items to point out. This compares with \$0.48 in the first quarter a year ago, after adjustments for the impact of divested operations and nonoperational charges in that period.

With our 4G deployment well underway, our capitalized interest will be significantly lower this year. As a result, wireless interest expense will reflect about \$150 million for each quarter this year. In terms of income taxes, the effective income tax rate attributable to Verizon for the first quarter was 30%. For the full year 2011, we are anticipating an effective tax rate to be in a range consistent with the past three quarters, post the Frontier and Alltel divestitures. Both of these items were fully contemplated in the overall earnings guidance we provided in January. With first-quarter growth of 6.3%, we are on track to meet our stated objective of 5% to 8% growth off an adjusted 2010 base of \$2.08 per share.

Let's turn to cash flow and capital spending on the next slide. In addition to the higher capital spending this quarter, cash flows from operations were impacted by higher acquisition and retention costs in wireless due to the iPhone, and the first-quarter funding of our full-year pension obligation, which was \$392 million. In addition, the first half of last year included cash flows from the divested properties.

In terms of free cash flow, we generated \$672 million in the first quarter, and although this is lower than our recent trend, our cash flow outlook for the year remains very strong. Many of the cash flows were timing, and this quarter did not impact our cash management planning for the year.

I would also say that there is no change in our thinking with regard to the timing of a Verizon Wireless dividend to its parent companies, which we believe will begin in 2012.

In the first quarter, total CapEx was \$4.4 billion, of which \$2.7 billion was wireless. While we expect overall capital spending in 2011 to be essentially flat compared to 2010, we have started the year more aggressively in wireless, spending a bit more early in the year on 4G LTE, consistent with our overall deployment plans and continuing to add growth capacity to our 3G network. Looking forward, we will continue to expand our 4G LTE footprint and invest the necessary capital in 3G to stay ahead of the data demand curve.

Wireline capital of \$1.5 billion was down 6.4% year over year. I would point out that we started last year in a very conservative manner, prudently spending only \$3.4 billion in the first quarter, given the higher level of economic uncertainty at that time.

In 2011, we will be very disciplined in the terms of overall capital spending matching our spending with growth opportunities.



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Our balance sheet remains strong, and we ended the quarter with net debt of \$47.2 billion and a net debt to adjusted EBITDA ratio of about 1.4 times.

On slide 6, we have displayed first-quarter revenues for each of the last three years, which is a good illustration of the transformation and growth of our revenue base. At our investor meeting in January, we talked about this changing revenue mix and how we have organized ourselves around the growth markets of the future based on a foundation of superior, high IQ networks that provide the platforms for innovation that we think are unmatched in our industry.

Today, 77% of our revenues are in higher growth areas, a sharp increase over the course of the last two years. As we look forward, we are big believers that our high IQ networks give us a strong strategic position and put us at the center of the trends that are driving growth in our industry.

In all these strategic areas, with our continued emphasis on advancing the deployment of our 4G LTE network in wireless, with our all-fiber network in mass markets, and through our ever-improving global and cloud computing capabilities for enterprise customers, we are well-positioned to drive higher top-line growth.

Let's now move into a review of the segments starting with wireless on slide 7.

As I said earlier, our wireless business had a very impressive quarter, with growth in retail customers and ARPU driving service revenue growth and profitability. Total revenue grew to \$16.9 billion in the quarter, up 10.2% year over year, with total service revenue up 6.3%. With the majority of our device sales occurring in the back half of the first quarter, we are expecting to see higher service revenue growth in the second quarter. In terms of retail postpaid ARPU growth, while we reported year-over-year growth of 2.2% in the first quarter, the month of March was 2.8% higher than last year, which is a good indication of increased revenue and ARPU growth in the second quarter.

In terms of new connections, we added a total of 1.8 million this quarter, with 906,000 net retail postpaid customers and 897,000 wholesale and other connections, including machine to machine. While our focus continues to be very much on the retail postpaid market, which continues to be the vast majority of our customer base, we are also broadening our portfolio of machine-to-machine connections in a number of areas -- vehicle tracking, meter reading, and alarm monitoring, to name a few. And we expect this to be an area of growth for us.

We generated \$6.3 billion of EBITDA in the first quarter, up 1.7% year over year. And while growth in this quarter was impacted by acquisition and retention costs, our service EBITDA margin of 43.7% remains industry-leading. We believe that our wireless EBITDA margins, while they may fluctuate in a given quarter related to successful device introductions, will end up in the mid-40% range for the year.

The incremental recurring revenue from smartphone and 4G device sales will help to mitigate the higher acquisition and retention costs. In addition, as I noted in January, we have also identified more than \$1 billion in cost-saving opportunities in wireless this year. I am confident that our wireless team will meet this challenge and achieve these savings.

Let's take a closer look at data growth and device sales on slide 8. Total data revenue grew \$1 billion or 22.3% year over year, and now represents 38% of total service revenue. A key driver of data growth in 2011 will be the increased penetration of smart phones in our retail postpaid phone base. To that end, we made good progress, ending the quarter with penetration of 32%.

Roughly 60% of all phones sold in the quarter were smartphones, up from 36% just one year ago. 65% of all smartphone sales were new to the category, meaning they were existing customers with feature phones or new Verizon customers.

With regard to the iPhone specifically, 48% of upgrades were new to the smartphone category, meaning the \$30 monthly data plan is incremental revenue. About 22% of our iPhone activations represent new Verizon customers.



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In terms of 4G LTE, we've seen strong demand for the HTC ThunderBolt and for the PC cards. On March 29, we introduced our first 4G Mobile HotSpot device, and this past Monday, we announced the availability of our second one. We think these 4G Mobile HotSpots will be very popular with customers, as they essentially allow any WiFi-enabled device to function as a 4G LTE networked device.

We expect demand for our 4G LTE products to strengthen as more smartphones, tablets and hotspots are added to our device portfolio. This includes the recent launch of the Novatel and Samsung mobile hotspots, as well as the addition of new 4G LTE smartphones in April, May and beyond. Clearly, our LTE network performance, our continued buildout and the successful early product launches are having a very positive impact on the development and strength of the entire LTE ecosystem.

As customer acceptance and enthusiasm for smartphones, tablets, and all kinds of connected devices gains momentum and becomes more integral to the people's personal and work lives, innovation will drive this entire category and expand the overall market.

With regard to the further expansion of our LTE footprint, we announced 38 markets in our initial launch in December, covering about 110 million POPs. Since then, we've announced more than 100 additional markets in places like Detroit, Memphis, Milwaukee, Louisville, Indianapolis, Sacramento, and Honolulu, to name just a few. By the end of the year, we plan to be in about 175 markets covering more than 185 million POPs. Let's take a closer look at ARPU next on slide 9.

Throughout last year, we saw accelerating postpaid ARPU growth, starting with 0.6% year-over-year growth in the first quarter and steadily ramping to 2.5% growth in the fourth quarter. In the first quarter of 2011, retail postpaid ARPU growth was 2.2%. We attribute this is to a few factors, but most notably to light sales in the early part of the quarter in anticipation of the iPhone 4 debut on our network in February.

As I said earlier, with much stronger device sales from that point forward, our exit rate for ARPU growth heading into the second quarter was much higher at 2.8%. Data revenue continues to be sourced primarily from Web and e-mail services, which increased to \$3.2 billion this quarter, up more than 38% from a year ago. Messaging, which makes up about one third of data revenue, is still showing growth, up 7% on a year-over-year basis.

At the end of the quarter, we had a total of 6.1 million Internet devices in our postpaid-base, with 364,000 net adds in the first quarter, driven by MiFi devices and 4G PC cards.

As you would expect, our churn metrics for this quarter were excellent. Our retail postpaid churn was 1.01%, improving by 4 basis points year over year. We are encouraged by the strong demand exiting the quarter and the positive implications for increased revenue and ARPU. You can expect us to effectively deliver both growth and profitability with a focus on gaining share in the retail postpaid market, increasing the penetration of smart phones, and selling more Internet devices, which will drive continued data revenue growth.

Let's move to our wireline segment next on slide 10. As I said earlier, we are seeing an improvement in revenue trends. The 2.2% year-over-year decline in the first quarter is 60 basis points better than the 2.8% decline last quarter. And if we exclude the effects of the international wholesale pricing change, total wireline revenues were down 0.7% year over year.

On the consumer side, our FiOS broadband and video products continue to drive a significant shift in our revenue mix. FiOS now accounts for 54% of consumer revenue, up from 45% a year ago. FiOS revenue in the quarter grew 23.7% year over year and FiOS ARPU is more than \$146.

On the global enterprise side, we had positive year-over-year growth, driven by strong strategic services growth of 12.8%. As with FiOS in the consumer market, strategic services are transforming our revenue mix, now representing 46% of total enterprise. Within this category, advanced services like managed network solutions, contact center solutions, IP communications, and our cloud offerings are growing very nicely.



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From a profitability perspective, segment EBITDA increased \$211 million or 9.7%, resulting in a 250 basis point year-over-year improvement in our EBITDA margin to 23.6%. The main reason behind the improvement was our workforce reduction initiatives in 2010 which help reduce our overall cost of labor.

Sequentially, we had a fourth consecutive quarter of EBITDA margin improvement, with an increase of 10 basis points to 23.6%. We achieved this through a combination of revenue stabilization and effective cost management, as the typical first-quarter cost pressures were offset by the effect of the workforce reductions.

Our goal is to achieve margin expansions in 2011 through continuous improvement throughout the year. And while it is unlikely that our workforce reductions in 2011 will come close to what we experienced last year, our focus on reducing our cost structure will be vigilant.

Let's take a closer look at the mass markets on slide 11. Within the mass markets category, consumer revenue of \$3.4 billion grew 1.9% versus last year. Consumer ARPU grew to \$90.55, an increase of 10.5% from a year ago.

The continued penetration of our broadband and video products have increased the scale of our FiOS platform and it is now significant enough to more than offset the secular and competitive pressures in this part of the business.

We had another solid quarter of customer growth in FiOS TV, adding 192,000 subscribers for a total of 3.7 million TV customers. Our FiOS TV penetration at the end of the quarter was 29%.

On the broadband side, we added 207,000 new FiOS Internet customers in the quarter. Our FiOS Internet customer base increased to 4.3 million, representing 33% penetration of homes open for sale. By adding in our 4.2 million high-speed Internet or DSL customers, we ended the quarter with a total of 8.5 million broadband connections. This reflects an overall increase of 98,000 broadband connections, which marks our best sequential growth since the second quarter of 2009.

As I have noted in the past, our customer satisfaction ratings are very high and our churn rates are very low. Our renewed focus on driving penetration in existing markets has been effective, and we are pleased with the overall progress in FiOS. We are off to a good start this year, and our pipeline for TV service is up 43% year over year.

Let's move next to our business markets on slide 12. While we are seeing some signs of improvement, revenues in the business market continue to be challenged by economic pressures. Global enterprise revenue was up 1% year over year. Strategic services drove the year-over-year improvement, led by a very strong growth in advanced services such as managed network, call center, IP communications, and our cloud offerings. As I have said, this category of services is becoming a larger part of our revenues, and we are incenting our sales force to sell these solutions to our enterprise customers.

As we experienced last quarter, the absolute dollar growth in strategic services outpaced the dollar decline in core enterprise services.

In global wholesale, revenues declined 11.2% year over year. As we've discussed, our route rationalization strategy has resulted in a sustainable decline in international voice revenue, worth \$162 million this quarter on a year-over-year basis. Since these price changes were initiated in mid 2010, I would say we have a few more quarters to work through before the comparative impact of these actions moderates.

Absent these effects, first-quarter global wholesale revenues declined 5% year over year. This decline is primarily in domestic voice where we continue to experience secular pressures and lower usage volumes.

I will wrap up here with the chart we used at our investor meeting in January, showing the keys to success in terms of executing our business model. We had a solid first quarter and a quality start to the year. Our early performance gives us great confidence that we are on track to meet our financial objectives and continue to position ourselves for future growth and profitability.



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As I mentioned earlier, we have built great momentum and have entered the second quarter in very good shape. We are seeing continued demand for our Apple products and 4G LTE devices, with more smartphones, tablets, and Internet devices coming to market shortly. As such, we expect service revenue growth and ARPU accretion to accelerate with each quarter this year. Our FiOS customer pipeline is very healthy, and we are very excited to add Terremark, one of the premier assets in hosting and cloud services to our portfolio of global assets and capabilities, enhancing our competitive position around the cloud opportunity and contributing to our growth.

I will stop here and turn it back to John, so we can open up the call to your questions.

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**John Doherty** - Verizon - SVP of IR

Thanks, Fran. Brad, let's open it up for questions please.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Jason Armstrong, Goldman Sachs.

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**Jason Armstrong** - Goldman Sachs - Analyst

Great, thanks. Good morning. First on postpaid ARPU, Fran, you had some helpful commentary on the exit rates at 2.8% in March. I guess what that implies though is that the entry rates in January were probably roughly 1.5% growth, which is a step down from the fourth-quarter rates. And it would seem to imply to me that the 4G laptop cards you launched in December, I guess it's logical that you would have over indexed sales here early in the quarter, which generally carry a little bit lower ARPU.

I'm wondering if you can offer granularity. Is that what happened? Just trying to put a finer point on sort of the progress to the quarter you had on ARPU.

And the second question on wireless margins, you talked about lumpiness in margins attached to handset launches; obviously two big launches in the quarter with iPhone and ThunderBolt, but it was only a partial quarter for both. So does that mean that in Q2 you would expect a bit of an incremental margin dilution as we get a full quarter of those devices? Thanks.

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**Fran Shammo** - Verizon - EVP and CFO

Thank you, Jason. Okay, so let's address the ARPU first. So, if you look at what we did, we came out of December at 2.5%, as I said in the previous comment. We had a very soft January. We continue to maintain our upgrades. If you recall when we launched the iPhone initially, we had a week of just upgrades to our current base, which we felt was important to show our loyalty to our customers who stayed with us even though we didn't have the iPhone.

And then we launched the iPhone, and we had people who were waiting for that device. So again, the first half of the quarter was soft. There was really no incremental ARPU if you will in that first half, given that sales were low and upgrades continued. But as we launched the iPhone, and if you think about it, it was only a half a quarter, but it's also important to realize that when we launched the iPhone, initially, we only launched it through our direct channel and a couple major retailers.

And then in the beginning of March, we launched it to the rest of our national retailers and some of our regional retailers, and we really weren't 100% out there with the distribution until mid-March.





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The second piece is, is that we only had two weeks of sales worth on the LTE device on smartphones. And then finally, we just launched the 4G device the last day of the month. So I think if you look at all of this and you look at the pro rate of access on these devices, that's why we only generated 2.2% of growth, but we accelerated to 2.8%. And as we said, we think that this will just continue to accelerate as the year goes on as we launch these into initial devices.

Now getting into your margin comment, no, I don't think that you will see a decline in the second quarter. The fluctuation, I believe, will come when a new device from Apple is launched, whenever that may be, and that we will be, on the first time, on equal footing with our competitors on a new phone hitting the market, which will also be a global device. So I think there will be some fluctuations when that happens, but we don't anticipate any fluctuation in the second quarter.

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**Jason Armstrong** - Goldman Sachs - Analyst

That's helpful. Thanks, Fran.

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**John Doherty** - Verizon - SVP of IR

Thanks, Brad. Can we move on to the next question, please?

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**Operator**

John Hodulik, UBS.

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**John Hodulik** - UBS - Analyst

Okay, thanks guys. Is -- a quick question on wireless, is 50% smartphone concentration still the target? Because I think it implies some accelerating penetration gains which would also support your view on the improvements in ARPU.

And then secondly, on the wireline side, you showed some progress there and I guess you will show some more progress when you lap the changes in the wholesale pricing. Is it possible that we see some wireline growth by the end of the year in wireline?

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**Fran Shammo** - Verizon - EVP and CFO

Thanks, John. So first off, on the 50% penetration, yes, we still are very confident in the 50%. And let me just be clear here because at the end of December, we labeled that we were at 26% penetration, but we changed the way we were calculating our penetration, so I want to make sure everybody's clear.

We were kind of -- we were doing a different calculation than the rest of the industry, so we changed to equal the rest of the industry, so that we had an apples to apples comparison. So if you look at the 26% we disclosed in December, it really was 28%. Now we ended this quarter at 32%.

This, I believe, is going to accelerate as we continue to launch and have a full month of Apple on the decks. Also, with the LTE launches, as you know, we only had two weeks of our first HTC handset. We are coming out with our Samsung handset very shortly here, and then LG will be following. So we will have up to three devices launched by the second quarter, so again, that's going to accelerate the growth, and yes, we are very confident that we will hit the 50% penetration.

And then on the wireline side of the house, I think as we continue here, we are confident that we can continue to expand the EBITDA margin in wireline. Obviously, there is a lot of cost reduction that has to take place. We continue to work out and look

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at the entire logistics ecosystem. We are continuing to reduce real estate. Last year, we reduced over 7 million and our target is equal for this year.

We have a whole garage study being -- taking place and we are closing garages and consolidating on that. So as you look at that continued margin, I think that's one piece of it. But as you mentioned, as we work ourselves out of the international voice decline year over year, and I think that will happen entering into the third quarter, if the economy starts to stimulate a bit, and we continue to obviously penetrate on the FiOS side, I think there is a good point where we could actually see some top-line growth out of the wireline segment.

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**John Hodulik** - UBS - Analyst

Okay, thanks, Fran.

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**John Doherty** - Verizon - SVP of IR

Thanks, John. Brad, can we move on, please?

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**Operator**

Simon Flannery, Morgan Stanley.

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**Simon Flannery** - Morgan Stanley - Analyst

Thanks very much. Good morning. You talked about closing the Terremark transaction, Fran. Are you able to give us any color on sort of headline trends for Q1 for Terremark?

And then, I think in the past, in March, you talked about unlimited pricing, reviewing that on your new devices in the summer timeframe. Perhaps you could give us an update on that. Thanks.

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**Fran Shammo** - Verizon - EVP and CFO

Thank you, Simon. So, on Terremark, we closed the transaction on April 11. We will have our first full quarter here in the second quarter. Terremark continued to grow at their steady pace of 20% through the first quarter. We believe that that will continue into the second quarter and obviously Bob Toohey and his team on the business side have a lot of integration activity going on with Manny and his team. And are going to hit the street strong with an offer here, a collaborative offer between the former Verizon business and the Terremark assets. So I think we're off to a good start there.

On the unlimited pricing, we are going to be going to a tiered pricing in midsummer this year. That is a definite, and you will hear more of that as we get there, but yes, we will be going to a tiered pricing for both 3G and 4G devices.

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**Simon Flannery** - Morgan Stanley - Analyst

Great. Thank you.

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**John Doherty** - Verizon - SVP of IR

Thanks, Simon. Brad, next question, please.

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**Operator**

Michael Rollins, Citi Investment Research.

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

Hi, thanks. Good morning. One question and then just a couple housekeeping things. On the question, can you talk a little bit more about the business markets, particularly what you're seeing in small and medium end of the market? And are you seeing any more competition from cable there?

And then from a housekeeping perspective, can you just give us the wireless replacement rate, device replacement rate during the quarter for postpaid; and where the wireless business ended on a net debt basis for the quarter? Thanks.

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**Fran Shammo - Verizon - EVP and CFO**

Okay, thanks, Mike. So, on the -- first off, on the SMB, I think what we will see is first, if you look at on the wireline side of the house and the overlap that we have there, obviously, we are at a disadvantage when you think about the DSL and the voice strategy that we have on the former copper plant. We're at a disadvantage to cable in that area.

But if you look at our FiOS, and where we have passed the prem and actually connect at the prem in small business. Our growth rate there is 37% year over year. So there is a difference between what market on the overlap of the wireline assets we're talking about. So I think that's important to note. But from an overall perspective, I think we are flat.

We've made some improvement year over year, but I will tell you I'm not happy with the progress in the small-business arena, and Bobby Mudge and his team are attacking that, but even within the Bob Toohey organization of Verizon business outside of the wireline footprint, with the Terremark acquisition, I think we have some unique offers that we can now make to the small-business arena around cloud, and I think that will help some of the offset of the former MCI mass markets which continues to decline.

From a housekeeping perspective, on net debt, from an overall perspective on net debt, we ended the quarter as I said at \$47.2 billion and wireless ended at about around \$12 billion.

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

Great, thanks. And just the wireless device replacement rate for postpaid? If you have that for the quarter, that would be great too.

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**Fran Shammo - Verizon - EVP and CFO**

Now, Michael, just to clarify, when you say replacement, you mean upgrades?

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

Yes.

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**Fran Shammo** - Verizon - EVP and CFO

Okay, so just a couple things around that. The other one point I want to make on the debt side of the house is that we have about, as I said, we have a \$4 billion maturity coming up here in May that will come out of wireless, so there's a maturity of about \$4 billion. So that will take the net debt down on the wireless side as well.

Then, on the upgrade side of the house, as we said, 60% of our sales were smartphones altogether. And as I said before, in January, I thought there was a major opportunity for us because our featured base as part of our postpaid base was significantly higher, and this was an area where we thought that we could make some good inroads into upgrading our feature phone base into a smartphone.

This quarter, 56% of our upgrades in total, and as you see from our release, we did about 3% a quarter, 3% a month, so it was about 9% for the quarter. So 56% of them were upgrades of feature phones or multimedia phones to our smartphones.

So when you think about that, if you look at a feature phone which has no data plan today, that's an incremental \$30 of ARPU and on a multimedia, they had a \$10 feature plan which now we get an incremental \$20 of ARPU. So I think from that perspective, I do believe that we still have some very good inroads here from a feature phone perspective. Going forward, we still have 62% of our base that are still on feature phones.

And then on a 4G side of the house, if you look at the adds that we did, 35% of them were new to category, and when I say that, they were also feature phones who upgraded into that. Now that's part of the 56% that I talked before, but just specifically on the 4G device, 35% of them were upgrades.

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

Thanks very much.

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**John Doherty** - Verizon - SVP of IR

Brad, can we take the next question, please?

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**Operator**

Brett Feldman, Deutsche Bank.

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**Brett Feldman** - Deutsche Bank - Analyst

Thanks for taking the question, and really appreciate all the color around the iPhone and the ThunderBolt, so I'm just going to ask for a bit more. If we just assume that you had a very strong launch around the iPhone, particularly to existing customers, it kind of looks like, as you exited the quarter, both devices might have been selling at about the same pace. So I'm wondering if that's a reasonable conclusion here.

And then you had mentioned how the iPhone didn't launch with full distribution, but that's expanded. Is that the same approach you are taking with your LTE devices? Or are you actually putting them in all of your channels on day one?

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**Fran Shammo** - Verizon - EVP and CFO

Yes, so, Brett, let me address a couple of those. So on the iPhone launch, we were cautious because we were not sure, obviously, of the demand that was there for the phone, and we wanted to monitor the supply and the demand so that we did not run into a backlog situation. From an HTC perspective, we are launching that across the board, so it is not a similar effect there.

Now, if you look at the iPhone, 78% of the iPhone were upgrades and 22% of those iPhones were new to our base. So if you do the math there, you can look at the iPhone dropped right down into our net adds for the quarter. And then, if you look at 4G and you add that in, 54% of our net adds were consistent with both the iPhone launch and the HTC launch. So 54% of our net adds came from those two devices alone.

So I think that from a pace perspective, we are very, very pleased with the HTC handset launch. You have seen probably some of the articles I have seen where people have tested it.

This is a true 4G device. You can put as much lipstick on 3 to make it a 4, but this is truly a 4G device with the speeds of 4G, and I think people are impressed and people will make their decision. So out of the gate, we are very happy with the volume, and I think that this will just continue as we continue to launch more 4G smartphone devices coming here in the next few weeks.

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**Brett Feldman** - Deutsche Bank - Analyst

Okay, so just one quick follow-up here. You're now selling the most popular 3G smartphone on the market, in the iPhone. You're selling the most popular 4G smartphone on the market. I know it's early days, but are you seeing anything meaningfully different in the way people are using the devices?

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**Fran Shammo** - Verizon - EVP and CFO

Not really. I think that with the 4G speeds, obviously, people are consuming more data. That will be expected given the video speeds and some of the TV download speeds, but keep in mind, though, that the 4G network is so much more efficient than the 3G network. So even with that incremental usage on 4G, even at the same price of 3G, the profitability is higher. So, it behooves us to move as many people to 4G as we possibly can, and you will see us doing that proactively in certain markets.

So from a different standpoint, yes, they are consuming more on 4G than they are on 3G, but we expected that.

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**John Doherty** - Verizon - SVP of IR

Brad, we'll take the next question, please.

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**Operator**

Phil Cusick, JPMC.

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**Phil Cusick** - JPMorgan Chase & Co. - Analyst

Thanks for taking my call. So, first, I wanted to see if we can get a little more detail on some of these things. You talked about the smartphone mix picking up from 60%. Can you give us what the March smartphone mix might have been as you saw that ARPU acceleration?



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**Fran Shammo** - Verizon - EVP and CFO

Phil, I don't have that detail. I just had it for the quarter.

**Phil Cusick** - JPMorgan Chase & Co. - Analyst

Okay. And then just following up on Brett's as well, the 4G data usage, you said, is higher. Can you give us an idea of what that is?

**Fran Shammo** - Verizon - EVP and CFO

At this point we're not going to disclose the usage on 4G. It's really way too early to deal with that because, as you know, as people get an initial handset, they initially download a lot of applications, so usage tends to be higher than the normal average, and we've only been at this HTC handset for two weeks. So I think it's premature to release anything like that.

**Phil Cusick** - JPMorgan Chase & Co. - Analyst

Okay. I'll try one more swing and then maybe I'll be out. So you talked about the iPhone being a global device when that launches. Do you anticipate that being a 4G device and sort of being at par in terms of speeds with your other 4G?

**Fran Shammo** - Verizon - EVP and CFO

Yes, I can't answer for Apple's product launch to be honest with you. All I know is it will be a global device. At that point I think we will have to go to Apple to find out exactly what that device will have.

**John Doherty** - Verizon - SVP of IR

Nice try, Phil.

**Phil Cusick** - JPMorgan Chase & Co. - Analyst

I tried.

**John Doherty** - Verizon - SVP of IR

Brad, next question, please.

**Operator**

Mike McCormack, Nomura Securities.

**John Doherty** - Verizon - SVP of IR

Mike, we can't hear you.

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**Operator**

Please stand by.

**John Doherty** - Verizon - SVP of IR

Brad, let's go to the next question.

**Operator**

Thank you. David Barden, Bank of America Merrill Lynch. Please stand by. Please stand by. Mike McCormack, Nomura Securities, your line is open.

**Mike McCormack** - Nomura Securities - Analyst

Sorry about that. Yes, just a couple of quick questions. First, -- and then, not to beat --

**Fran Shammo** - Verizon - EVP and CFO

(multiple speakers)

**Mike McCormack** - Nomura Securities - Analyst

Not to beat the ARPU thing to death here, but you guys have identified, obviously, some backend loading of the smartphones, and I think that's good color. But thinking about ARPU growth, can you sort of identify the offsets which might be coming in the form of voice pressure from family share roaming?

And then how should we think about data devices like tablets and sticks and cards and stuff like that, that may carry a lower overall ARPU, which could sort of have an impact on the growth rate, but obviously driving some decent adds.

And then secondly, and it might be premature, but thinking about the iPhone guidance for the year based on 11 million, the 2.2 million tracking a bit lower, not surprising given a partial quarter, but it's also the launch quarter. So just trying to figure out what your thought process is there. Obviously we're anticipating a refresh at some point during the year that obviously could boost that as well. But just some thoughts around that would be great.

**Fran Shammo** - Verizon - EVP and CFO

Sure, thanks, Mike. So from an ARPU perspective, from a voice ARPU perspective, we are obviously seeing a decline there, but it is a slowing decline year over year. So, yes, that is putting pressure on us but it is putting a pressure on us at a slower rate and we view that as, that will continue into the future. Also, from a voice ARPU perspective as we launch the iPhone, I guess I would be remiss to say that the call quality on the iPhone has been spectacular on the 3G CDMA network. And obviously, we think that our voice will continue to slow as we add more iPhones and people realize the quality of the voice network and the data network there. So, I think that will be fine.

From a tablet and a broadband access device perspective, there is some small dilution going on from the old price plans to the new price plans, but we don't see that as being a drag to the overall ARPU as we continue to penetrate into the tablet scenario, into the 4G MiFi devices and the usage that the MiFi devices will bring and the tiered pricing that we already have related to our data products. So I don't see that as being a major issue going forward.

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And as far as the 2.2 million in the first quarter and the 11 million overall, we are sticking with our 11 million view for our guidance purposes.

**Mike McCormack** - *Nomura Securities - Analyst*

Great. Thanks, Fran. I appreciate it.

**Operator**

David Barden, Bank of America Merrill Lynch.

**David Barden** - *BofA Merrill Lynch - Analyst*

Thanks, guys, for taking the question. Just two if I could, maybe. Fran, just starting with the debt raise recently, this past quarter, and kind of bulking up on the balance sheet, both coming out \$9 billion or so, \$7 billion going into cash. Obviously, we've got the Terremark deal cash going out the door, but is this cash that we put on the balance sheet really about trying to avoid the necessity of upstreaming dividends or maintaining leverage at the Verizon Wireless business? Because I did notice that you guys kind of called out that specifically in the call today that you didn't want to have to do anything on the dividend until next year, but because you are not, you had to go into the markets and raise this money and put cash on the balance sheet. And I just wondered if you could kind of talk through your thinking there.

And I think the second question if I could is just maybe more strategically thinking about the industry consolidation. I think you guys have come out as fairly neutral on AT&T's prospective acquisition of T-Mobile. With the caveat, as long as it doesn't lead towards incremental regulation of the industry. Could you talk a little bit about what kinds of regulations you think would be the kinds of regulations that would get you up off the bench to kind of come in and oppose this deal? Thanks.

**Fran Shammo** - *Verizon - EVP and CFO*

Okay, thank you, David. So first on the debt side of the house, yes, we actually went out into the market because we have some debt maturities both within corporate and wireline this year that needed to be refinanced. And when we initially did it, the interest rates were so well we took advantage of the interest rates and raised it to \$6.25 billion. We have about \$2 billion worth of maturities coming in the back half of the year. We had a \$500 million refinancing that took place in the first quarter.

We also wanted to refinance some of our CP paper, commercial paper, so we did that as well. And due to the lucrativeness of the interest rates we had, we also decided to prefund our pension plan of \$400 million, both to take effect of the interest rate and the arbitrage on that. Compared to the return that that \$400 million would get in the pension plan, that would help us alleviate some of our future cash flow obligations into the plan. So this really was all around just a refinancing and rebalancing of our balance sheet; and just for general other observations; and as you said, pay for the Terremark; and also to refinance the Terremark debt.

And then from an AT&T and T-Mobile merger perspective, I guess the comment I would have is we have to let that go through due process with the federal government. And we will sit and wait and see.

Obviously, we will then take a view of, if it's a market-based condition merger, we will be fine with that. If it's a regulatory merger, then we will have a harder time with it. Now, as far as what may have been a little bit off here is I'm not going to go into what types of things we may object to, but obviously we are a very strong on where we stand with net neutrality. We are very strong where we stand with data roaming, and the positions that the FCC have recently taken there.



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And we will not stand by if there are certain regulations put on us that we have to deliver certain things at a fixed price that's set by a regulatory arm that has no authority over that regulation of price. So we will sit back, let it go through its due process and then we will see what happens.

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**David Barden** - *BofA Merrill Lynch - Analyst*

All right, guys. Thanks.

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**John Doherty** - *Verizon - SVP of IR*

Thank you, David. One or two more questions, Brad. Next question, please.

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**Operator**

Tim Horan, Oppenheimer.

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**Tim Horan** - *Oppenheimer & Co. - Analyst*

Good morning. Thanks, guys. Two broader questions. Fran, on the managed services front, I know it's early in the process here, but do you find yourself bumping up against more of the traditional IT outsourcers in the market? And do you have the capabilities you need in managed services at this point, or do you need more acquisitions?

And then secondly, on the smartphone side, could you talk about ultimately what you would like to see in terms of number of suppliers on the different platforms and maybe market share platform?

And related to this, the subsidies per handset, do you think we're at peak run rates here and they can start to decline? Or do you think we will see handset subsidies on the smartphones increase for a while? Thanks.

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**Fran Shammo** - *Verizon - EVP and CFO*

Okay thanks, Tim. So on the managed services side, I think that we have the portfolio of assets that we need to be very successful in this piece of the business, and I think we have shown that with some of the wins that we have publicly stated here in the past. And you're absolutely right, we are actually entering into a market where we are competing with many different players depending upon where you are in the globe.

Especially here in the US, we go up against all of the integrators and some of the other service providers, but outside the globe, we hit on a bunch of different players like Tata and Infosystems and people like that. So it depends where you are on the globe, but we think we are very well positioned with our portfolio. And we have shown this with our strategic services growth of 12.8%.

Some of the growth this quarter and the reason it jumped up was driven by our managed services business. So I think we are starting to really gain new ground here. We have proven ourselves with some of the major undertakings that we have taken with some of our announced deals with Matsui and JetBlue and others. So I think we've got a good stance, and I don't think we need to do any more major acquisitions in this portfolio.

As far as the smartphone side of the house and subsidies, I think first, we are charging a premium on the 4G smartphone, so the subsidy obviously there is less than others. But we'll have to see how the market goes, and I would assume that this market will mature the -- similar that a feature phone market matured over the years where as more players become into the marketplace and we have new entrants like maybe a Huawei down the road, there will be -- put pressure on the other manufacturers to get

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more efficient and reduce price, and then that will help our subsidy go. So I think the maturity of the market and the ecosystem will eventually take care of itself.

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**John Doherty** - Verizon - SVP of IR

Thanks, Tim. Brad, last question, please.

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**Operator**

Jonathan Chaplin, Credit Suisse.

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**Jonathan Chaplin** - Credit Suisse - Analyst

Good morning, guys. Thanks for taking the question. So, one question, AT&T gave, as one of the -- or two of the justifications for the deal, getting access to a lot more spectrum and increasing their cell site density quickly. I think after this transaction, they're going to have significant -- you know, 50 megahertz or so more spectrum than you, and then cell site density, which is 25% to 30% more dense than yours as well.

Can you talk about how you see your spectrum needs evolving over the course of the next three to five years? And what you think you need to do from a cell site density perspective to keep up with the rapidly growing data demand that you're seeing? Thanks.

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**Fran Shammo** - Verizon - EVP and CFO

Sure. Thanks, Jonathan. As we said before, we think we are in a very good spectrum position. We think we have the spectrum we need, and are in a good position until about the year 2015 at this point. And we will continue to keep our eyes open to see where we need to buy spectrum or secure spectrum. But right now we are in a very, very good position. I'm not going to speak to the competitor. You can ask those questions as to why they did this and why they needed the spectrum, but I think we're in a very good position.

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**John Doherty** - Verizon - SVP of IR

All right. Thanks, Fran. Thanks to all of the participants that joined us this morning. And with that, Brad, let me hand it back to you to complete the call.

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**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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