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# EDITED TRANSCRIPT

VZ - Q1 2012 Verizon Earnings Conference Call

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**OVERVIEW:**

VZ reported 1Q12 EPS of \$0.59.



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## PRESENTATION

### Operator

Good morning and welcome to the Verizon first-quarter 2012 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 Communications Inc. - SVP of IR*

Thanks, Brad. Good morning, and welcome to our first-quarter 2012 earnings conference call. Thanks for joining us this morning. I am John Doherty. With me this morning is our Chief Financial Officer, Fran Shammo.

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. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risk and uncertainties. Discussion of factors that may affect future results is contained in Verizon's filings with the SEC, which are also available on our website.

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

I would like to state that all quarterly growth rates disclosed in our presentation slides and during our formal remarks are on a year-over-year basis unless otherwise noted. Also, there were no special items of nonoperational nature included in our reported results for the first quarter of either this year or last.



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

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

Thanks, John. Good morning, everyone. Before we get into the details, let me start with a few comments about our first-quarter results.

On our last earnings call in January, I talked about the confidence we have in our ability to benefit from the market opportunities we see in our key strategic growth areas. Our focus will continue to be on execution, striving to capture incremental revenue and driving operating efficiencies throughout the business.

With the results of our first quarter, we continue to execute and deliver on the guidance we gave back in January of 2011 and reaffirmed earlier this year. We remain as confident in the direction of our business now as we were then and we continue to deliver strong results.

Earnings per share were \$0.59, up 15.7% over first quarter last year. In Wireless, we saw a sharp acceleration of growth in retail service revenue and postpaid ARPU, driven by increased smartphone penetration and higher data device adoption, resulting in increased usage. This top-line growth, combined with effective cost management, resulted in a very strong service EBITDA margin.

Consumer retail revenue growth also continued to improve, driven by another solid quarter of FiOS performance. Our broadband net adds were the highest we have seen in nearly three years. We had an extremely strong quarter of cash generation. Free cash flow of \$2.4 billion is more than 3.5 times the amount generated a year ago. The first quarter is normally the lowest quarter of the year, so we expect to see increasing free cash flow levels going forward.

Capital expenditures in the first quarter were down more than 18%, as our disciplined approach is resulting in capital efficiency gains and an improving return on investment profile for the entire business. Let's begin our review with a look at consolidated results on slide 4.

Our consolidated results show strong growth this quarter. On the top line, our growth trends continue to be very positive coming from all strategic areas, most notably wireless services. This quarter, overall revenue growth far outweighed the increase in operating expenses, resulting in double-digit operating income growth of 16.7%. Consolidated EBITDA grew to \$9.2 billion and our margin expanded to 32.7%, up 130 basis points year-over-year and 210 basis points sequentially.

Let's turn now to cash flow and capital spending on slide 5. Our free cash flow this quarter increased \$1.7 billion, driven by reduced levels of capital spending and an 18% increase in cash from operations. Capital expenditures totaled \$3.6 billion in the quarter, a decrease of about \$800 million compared to last year.

Our overall capital efficiency continues to show steady improvement. We expect our annual CapEx-to-revenue ratio to decline for the full year, based on improving revenue trends and disciplined capital spending.

In Wireless, capital spending in the quarter was \$1.9 billion, which was lower by \$850 million, or 31%, from the first quarter last year. You will recall that at this time last year, we were spending more to meet 3G capacity requirements in connection with our initial launch of the iPhone. As we move through the year, you will see a continued focus on migrating traffic from 3G to 4G LTE, which will drive additional improvements in our capital and operating efficiency. We will also continue to expand our 4G LTE network coverage, which is already the largest in the nation.

In Wireline, capital spending was \$1.5 billion this quarter, about 5% higher than the first quarter last year. This increase is due to timing, strategic spending in enterprise and some copper-to-fiber migration within our residential customer base.

Our balance sheet remains very strong. You will recall that the \$10 billion cash distribution from Verizon Wireless was paid this quarter. We used our proportionate share in part to pay down commercial paper and to redeem a maturing bond. As a result, total debt declined by \$3.6 billion since the end of last year. Our net debt to adjusted EBITDA ratio was about 1.3 times at the end of the quarter.



Let's now move into a review of the segments, starting with Wireless on slide 6. Our Wireless business had an impressive quarter and a strong start to the year, posting accelerated growth in service revenue and our highest retail postpaid ARPU accretion in three years. Total Wireless revenues of \$18.3 billion grew 8.2% and now represent about 65% of Verizon's consolidated revenue.

Retail service revenue growth accelerated to 8.9%, 110 basis point increase in growth from the fourth quarter and the highest growth rate we've seen since early 2009. We are seeing strong revenue growth from multiple postpaid sources, smartphones, tablets and Internet devices, and retail prepaid revenue grew strongly again this quarter, up 17.3%.

Total service revenue grew 7.7% this quarter, 130 basis points higher than the growth rate in the fourth quarter. Total data revenue of \$6.6 billion grew 21.1%. Data now represents nearly 43% of total service revenue. Data revenue growth continues to be driven by Web and e-mail services, which increased to \$4.3 billion in the quarter, up nearly 36%.

Let's take a closer look at our connections growth on slide 7. We continue to gain share in the retail postpaid market, driven by sustained demand for our 3G and 4G LTE handsets, tablets and Internet devices, with the unmatched service quality of the nation's largest and most reliable wireless network. We have an industry-leading 93 million retail connections, 88 million postpaid, and 5 million prepaid. During the quarter, we added 734,000 new retail net connections, 501,000 postpaid and 233,000 prepaid.

Before we discuss postpaid in more detail, I would point out that within the prepaid net adds, 138,000 were tablets. About 60% of the prepaid tablets this quarter were 4G LTE.

Within the retail postpaid category, gross additions were just over 3 million, down about 12% from a year ago. We believe this decline is both seasonal and a function of the timing of the new device launches last year. Our porting ratios with all carriers are favorable and our postpaid churn metrics remain excellent. Although the first to report, we are confident that our 501,000 postpaid net adds is a strong result.

Postpaid device sales, both gross add and upgrades, totaled about 10 million this quarter, with 8% of our postpaid base upgrading devices. In addition to smartphones, we are also having great success in the Internet device category, which includes tablets. This quarter, we sold 765,000 4G LTE Internet devices, which is more than last quarter. We are the market leader in this space, as mobile hotspots or Jetpacks, USB modems and tablets represent 8% of our retail postpaid connections. I would also point out that 62% of our active tablet base is postpaid.

Next, let's turn to slide 8 and take a look at our smartphone and retail postpaid ARPU metrics. We had another strong quarter of smartphone sales, increasing the penetration of our retail postpaid phone base to 47%. 72% of all retail postpaid phone sold this quarter were smartphones. We sold 3.2 million apple iPhones and sold 2.1 million 4G LTE smartphones this quarter. We sold 500,000 or 30% more 4G LTE smartphones this quarter than we did in the fourth quarter.

Consistent with prior quarters, about 20% of our smartphone sales are gross adds or new to Verizon, and the rest are upgrades from our existing customer base. Within these upgrades, 42% are customers buying a smartphone for the first time, representing incremental recurring data revenue. This is a significant point of differentiation and a strength for us.

Retail postpaid ARPU was \$55.43 this quarter, up 3.6%. This is a big acceleration in accretion over what we experienced in 2011. Growth in retail postpaid phone ARPU accelerated to 4.9% this quarter and now exceeds \$57.

Postpaid Internet device ARPU was about \$48 this quarter, a decline of 8.7% from last year, but an improvement from an 11% year-over-year decline last quarter. Although postpaid ARPU for Internet devices is less than for phones, we are seeing double-digit year-over-year revenue growth, driven by increased unit sales. We already have a majority share in this important category, and we continue to expand the market for devices which enable higher usage. We also expect more network efficiency as an increasing percentage of data traffic moves to our 4G LTE network.

Let's turn to slide 9, as I would like to spend a few more minutes talking about the strength of our 4G LTE leadership. We are by far the market leader in 4G LTE, which is now available in 230 markets and more than 200 million POPs covering over two thirds of the country. Throughout the year, we will continue expanding our 4G LTE network, with a goal of having a nationwide footprint similar to our 3G network by mid-2013.



We are seeing increasing customer awareness of the capabilities of 4G LTE and a growing recognition of the superior performance of smartphones, tablets and Internet devices on the Verizon 4G LTE network. Third-party comparisons of our 4G LTE network performance compared with others generally ranks us highest in terms of consistency of access, performance and speed, with better average download speeds and significantly higher average upload speeds.

In addition to our network deployment and coverage advantage, sales of 4G LTE products are clearly gaining momentum. In the first quarter, we sold 2.9 million postpaid smartphones and Internet devices, a 22% increase over the fourth quarter. The vast majority of devices we have for sale are 4G LTE. We now have a total of 8 million 4G LTE customer connections, representing 9% of our postpaid base. Of note, about two thirds of these are smartphones.

We remain very pleased by our 4G LTE progress. The Verizon 4G LTE network has become the destination of choice for consumer and enterprise customers, which is a very positive indicator for us looking forward.

Let's conclude our Wireless segment review with a discussion about profitability on slide 10. In the first quarter, we generated \$7.1 billion of EBITDA, which is an increase of 14.2%, and expanded our service EBITDA margin by 410 basis points sequentially to 46.3%. Our margin performance is once again a testament to our ability to execute very well on our strategy of balancing growth and profitability. The combination of accelerating service revenue and ARPU growth, an intense focus on cost controls and consistently excellent churn metrics are contributing to our industry-leading margin performance.

Going forward, we will continue to look at opportunities to mitigate the cost of higher equipment subsidies and commissions. We have identified \$2 billion of cost-saving opportunities for this year and we are on track to capture these savings. We also announced a \$30 upgrade fee, which will go into effect next week.

Let's move to our Wireline segment next on slide 11. Total Wireline revenue declined \$202 million or 2% in the first quarter. About 60% of this decline is a result of targeted product rationalization actions we have taken to improve the quality of our revenue mix.

Within wholesale, I'm referring to our continued exit from unprofitable international wholesale routes and contracts. In enterprise, it is our deemphasis on selling of drop-ship hardware or CPE. In the Other revenue line item, the majority of the \$82 million decline this quarter was from nonstrategic products, which include the former MCI mass markets business, long distance, local wholesale and calling cards, public pay phones and directory assistance. We are exiting the calling card and public pay phone businesses entirely.

While the Wireline revenue decline was accentuated by these targeted actions this quarter, growth in the strategic areas continues to mitigate the more secular and cyclical declines in other parts of the business.

As we have stated, we are taking a hard look at all of our product lines and rationalizing those that are not meeting our strategic and financial requirements. For example, going forward, we will no longer be selling high-speed Internet or DSL over copper in areas where FiOS is available.

From a profitability perspective, first-quarter EBITDA declined by \$148 million year-over-year, with 100 basis point decline in the EBITDA margin to 22.6%. The decline is due to several factors. Revenue declines in less strategic products and first-quarter cost pressures, like higher OPEB accruals, increased active benefit costs and escalators in certain content contracts. We have targeted price actions planned to help offset certain cost increases, which will contribute to our overall profitability goals this year. I remain confident that we will achieve EBITDA margin improvement for the full year, and we continue to be very focused on improving the long-term profitability of the Wireline business.

Let's take a closer look at our revenue performance, starting with mass markets on slide 12. As a result of the scale of FiOS and increased penetration, consumer ARPU has continued to steadily increase and is now over \$97, up 8%. In addition, our residential connections trends continue to improve. We lost 205,000 retail residential connections in the quarter, representing a 6.8% decline year-over-year, compared with a loss of 289,000 or 8.6% at this time last year.



In the first quarter, we delivered strong broadband growth, gaining a total of 104,000 net subscribers. With 193,000 FiOS Internet additions, we passed the 5 million FiOS subscriber mark and increased our penetration to 36.4%. More than half our FiOS customers already use 20 megabit speed or higher, and with more devices like tablets, game consoles and smart TVs connecting to the Internet at home, demand for higher broadband speeds is on the rise. Later this year, we plan to introduce a series of higher-speed packages that will further differentiate FiOS as the nation's fastest Internet service and allow us to continue to monetize our investment in the FiOS platform.

In FiOS video, we added 180,000 subscribers in the quarter, bringing our total to 4.4 million and increasing our penetration to 32.3%. Within our FiOS subscriber base, about 68% are triple play, and our FiOS ARPU now stands at more than \$148 per month. Our focus continues to be on increasing FiOS penetration, realizing additional operating and capital efficiencies and expanding margins.

Let's move next to our business markets, starting with global enterprise. Strategic Services continue to drive the overall positive growth in global enterprise revenue. We continue to post double-digit growth in application services like managed network, data center, security, cloud and IT infrastructure. Within the IP layer, private IP and ethernet services are contributing to the growth.

In the first quarter, these services totaled \$2 billion, up 11.6%, representing just over half of global enterprise revenue. As we have seen for the last several quarters, the growth in Strategic Services did outpace the decline in core enterprise services, but not to the same degree.

As you might expect, we are experiencing some short-term revenue pressure from Europe and foreign currency. In addition, our deemphasis on sale of hardware was worth about \$43 million on a year-over-year basis. Growth in services revenue was 2.3%.

Looking ahead, we do expect our enterprise business to contribute more to the overall Wireline revenue growth and profitability.

Our strategic repositioning of Verizon Enterprise Solutions has better aligned our strengths in high-growth markets like cloud computing, machine-to-machine and advanced communications. Our acquisitions of best-in-class assets like Cybertrust, Terremark and CloudSwitch, combined with our industry-leading 4G LTE and global IP networks, gives us a unique platform of assets to provide comprehensive, integrated solutions to enterprise organizations.

In global wholesale, revenues in the first quarter declined \$181 million or 8.9%, due primarily to declines in voice and local services. As I said, we continue to take targeted actions to exit unprofitable routes and contracts, to improve the quality of our revenue mix during this period of secular decline and lower volumes. Partly offsetting these declines were continued growth in certain data services, most notably fiber-based ethernet.

Let's move now to our summary slide. Overall, we had a solid start to the year, and we remain confident in our ability to take advantage of the market opportunities we see in our key strategic growth areas. We are on track with our plans, and we expect to continue to deliver strong results going forward.

Our focus will continue to be on execution, striving to capture incremental revenue and driving operating efficiencies throughout the business. Our success in stimulating top-line growth and capturing cost savings will enable us to mitigate certain secular declines and cost pressures.

In terms of recent news, yesterday, we announced plans to conduct an open sale process for all of our 700 megahertz A and B spectrum licenses in order to rationalize our spectrum holdings. We acquired these licenses as part of the FCC Auction 73 in 2008. The sale of these licenses is contingent upon the close of the purchase of the AWS licenses from SpectrumCo, Cox and Leap Wireless. These transactions are at varying stages of review by the FCC and the Department of Justice and are expected to close by midsummer.

In closing, I would reemphasize that we are well-positioned to capitalize on the investments we've made, further improving investment returns and creating significant shareholder value in the years to come.

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



**John Doherty** - Verizon Communications Inc. - 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

Good morning. Fran, couple questions. First on Wireless ARPU. Very healthy uptick in the retail postpaid growth rate. Can you help us think through prospects for further improvement in the rate of growth from here?

And then second question, just on Wireline margins. I think the reset in the first quarter was a bit larger than most of us had initially expected sort of going into the process. You talked about confidence in improvement from here. Just wondering how should we think about the pacing of this through the year? Would you expect it to be fairly linear and show up in the second-quarter results or is this more back-end loaded and maybe contingent on a union contract? Thank you.

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

So let's start -- these are two, actually, big questions that probably will result in larger answers than you would expect. But on Wireless ARPU, let's start out with the fact that I think as we started out in 2011, we said that we had a path to accelerate the growth of our revenue. We came out of the fourth quarter; I reiterated my confidence on that projection. And as I sit here today, and I will continue to reiterate that we are confident we will continue to accelerate our growth in this category.

And it is going to come from many, many different areas. So you have to keep in mind, number one, our smartphone penetration is at 47%, which means that there are 53% of our phone customers that are still on a basic phone. So we still have a lot of roadway here from a basic to smart upgrade. And as you know, 42% of our customers this quarter went from a basic phone into a smartphone category. So that is accelerating the growth.

In addition, as you heard on the script, our Internet device category is starting to stabilize a bit, and we expect that to continue to go throughout the quarter on an ARPU basis. As last year we reset prices, we expanded the category, so the growth of that category is expanding for us. But we knew we had some short-term ARPU pressure by the price resets that we launched into the marketplace. But that set us up for our 4G LTE launches, and as you saw, we had a stellar performance on the number of devices that we moved on our 4G network this quarter.

So that's a couple things. I probably could go into a lot more detail around our data-sharing plans, our commercial launch of Fusion, and if we want to get into more discussion on that, we can. But we are very, very confident that we are on a path to continue to accelerate the growth of our ARPU.

On Wireline margins, just a couple things here to talk to. Number one, we did have the FiOS-to-copper migration, which impacted our short-term results. But we've talked that this is a strategy that we are deploying. It is better for us long-term to get most of these customers off of our copper network to our FiOS network, as you saw that we are -- stopped selling our naked DSL in FiOS-covered area. And we started to convert a number of customers in this quarter over to our FiOS network from a voice perspective.

Now, a couple things here that this will launch. Number one, we will see a long-term benefit in our repairs and maintenance decrease over time. We will also get the upsell capability to start selling these voice customers on better speeds of FiOS and better experience, and also then into the linear TV product that we have to offer. And what we are seeing is the minimal number that we converted last year during our trials, we are starting



to see a 30% sale upgrade on those customers. But it does take us three to six months to convince those customers to upgrade. So this is a longer-term type strategy.

In addition, going into the future, you are going to see -- you may have already saw -- that we are starting to do some price-ups in strategic areas. We've already started that in April, but over the next two quarters, we're going to have several price-ups in our FiOS packages. In addition, we are going to rebundle certain of our packages to better bundle our content in order to make it more profitable, based on the tier that you pick for us.

The other thing is that there is other revenue streams coming down the pike, like home monitoring control, that will contribute to the overall ARPU of our FiOS platform.

We also have a very disciplined cost structure in place, as you see that we declined our SG&A expense year-over-year. In April, we also had another ISP to our represented employees, which we had a number of people take. So we've already taken off 1100 people from payroll since the quarter has closed.

We are taking other measures around the consolidation of our back-office operations, as I've talked to in the past. You see that we are exiting some of our unprofitable or low-margin businesses, which will help us in the future. And then of course the union contract, and we can talk more about that. But obviously, the business needs a cost restructure, and that is what that is about.

So I will stop there. I'm sure we will have some more questions here.

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

That's really helpful, Fran. Is there any way you could quantify the copper-to-fiber sort of incremental cost in the quarter?

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

At this point, we are not going to disclose that. It did result in some incremental capital for pre-positioning, and then it did result in some expense for us. But actually, for this quarter, it was not a big component of the quarter.

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

Okay, thank you.

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**Operator**

John Hodulik, UBS.

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

Thanks, guys. First -- it's two quick ones. First on -- I guess a follow-up on the Wireless side. You saw 260 basis points of annual margin improvement in the first quarter, and now talking about accelerating ARPU growth. And like you said, that \$30 that gets -- that gets -- that's started -- gets tacked on to upgrades in May. Is that a decent number? Or I guess why shouldn't we expect that kind of year-over-year increase in margins or maybe even better as the \$30 starts to flow through?

And then second of all, maybe on use of cash, could you remind us what your target leverage ratio is? We are at, I guess, 1.3 now, given the debt paydown. As we look out to next year and we are modeling another dividend, obviously you don't want to chat -- you don't want to sort of look that far out. But I'm just trying to get a sense for sort of use of cash as we go forward. Thanks.





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

On the Wireless margin expansion, I guess there is a couple things here that are important. Number one is, as you know, we have been on a two-year track here to reduce expenses in our Wireless unit, and over the last two years we've taken out about \$3 billion of expense. This year, we have another target of \$2 billion.

So I know that everyone is focused in on the subsidy model, but as I've said, that is just one line item in our P&L, and it takes managing the entire business to be an efficient business. And I think that Wireless has done a really excellent job on reduction of cost and creating more efficiency within the model. And that is what is driving the margins, besides the ARPU increases that you see in the revenue growth.

And as we stated last year, coming into this year, that our goal was to get back to our third-quarter level of last year's margin, and then continue to grow from there. And we are putting in all those actions to do that.

As far as the \$30 upgrade fee, I will remind everyone that we started back in 2010 on a strategy to start to take out some of the lucrative promotions we had around upgrades by deleting the New Every Two program, limiting the amount of early upgrades that we allowed. And now the implementation of the \$30 upgrade fee, which we were the last carrier to implement. But it is important for the overall profitability of the business and the experience that we expect to have within this business.

So I think there is a number of actions that Wireless is taking to continue to focus on the ARPU expansion and then the margin expansion, because we like to do both at Verizon; we grow and we expand our margins.

And then as far as the use of cash here, on a targeted net debt to EBITDA, it is more important that I think we are comfortable with our net debt to EBITDA ratio. This will improve over time, as we continue to delever in certain areas where we think it is reasonable to do. You saw us take the proceeds of the Wireless dividend this quarter to pay down some debt that was maturing that was high-interest debt that quite honestly didn't make sense at this time to refinance in any perspective.

So we will continue to manage our cash -- important. Our dividend policy is extremely important to us. And Lowell and I have said very strongly that we will continue the policy of our dividend. So I will stop there and we will go on to the next question.

**John Hodulik** - UBS - Analyst

Okay. Thanks, Fran.

**Operator**

Simon Flannery, Morgan Stanley.

**Simon Flannery** - Morgan Stanley - Analyst

Good morning. You talked about the Wireline margins, and I think there was a question about the union contract. Could you give us an update on where you stand and the ability to sort of move forward and get progress, some agreement over the coming quarters?

And then on Wireless adds, you had, I'm sure, the best in the industry. But overall, we expect the industry to be flat to down on postpaid. Do you sense this is just a lull post the iPhone 4S launch last quarter? Did you see sort of a pickup sequentially through the quarter? Any thoughts about how the rest of the quarters pan out in terms of Wireless versus Q1? Thanks.



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

First, let's talk about the union contract. Look, I think it is safe to say that as we entered into this negotiation, we knew that this was going to be an extremely difficult negotiation. We have said very strongly that we need cost structure within the Wireline business. Obviously, if you look at the profitability of this business over the last five years, it has decreased, and this cost structure is not palatable going forward. So we need some concessions. We need healthcare contributions. We need some pension revisions.

And look, we are not asking for things that have not already been given to other companies. These are not new issues. They've already been given to some of our peer companies. So we are standing strong. We need this cost restructure in order to build on the profitability of our Wireline unit.

The other thing is, look, we've invested over \$24 billion into this unit on the FiOS platform. And in order for us to be competitive with our competitors of cable, who don't have these very lucrative benefits and average salaries of \$90,000, with an incremental \$50,000 of healthcare and pension on top of that, we need some cost restructure here.

So look, this is a hard negotiation. It took one of our peer companies over 500 days to get to where they were three years ago in some of these breakthrough issues. So we continue to negotiate, we continue to put proposals on, and we'll see where we go. But we knew this was going to be a long haul, and with my comment of improvement of Wireline margins, it is all built into those comments.

On the Wireless adds, I think we are extremely pleased with the growth of our Wireless business on an add basis. If you look at, though, there is going to be other categories that drive the growth of Wireless in the future. As I said, we will be launching our data share plan in midsummer this year. We believe that plan, the way we have it designed, will enable our customers to easily connect other devices to that plan.

And I think that as we do more connections -- you notice that we did not disclose total connections. As I've said, that machine-to-machine is becoming a more complicated device and connection of the way the plans are built. So it is not important anymore of total connections. It is more important of our revenue increase based on the customers that we are growing.

I think that if you look at our Fusion product that we just launched in certain states, our trials are going very well. The customers' experience is extremely strong. We have a target of 10 million homes that we are going to launch to in May of this year, when we commercially launch. And that will build to -- as we build out the 4G LTE footprint -- to a target of 34 million homes. We believe that is a growth engine for us in the future.

Then we have tablets. We have prepaid. This is the second quarter in a row where we have grown our prepaid base with our Unleashed product. And in the next week or so, you are going to see us add in a smartphone to our prepaid product on an \$80 price point with 1 gigabit of data.

So there is a number of actions that we are taking. If you think about the third ecosystem and then also the cable partnership, that we also just launched some new markets with Time Warner Cable this past quarter, Kansas, Ohio and Carolinas. So we continue to expand. I think we have a great path to increased adds on a full-year basis here, and we are on that track.

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**Simon Flannery** - Morgan Stanley - Analyst

Thank you.

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**Operator**

Phil Cusick, JPMC.

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**Phil Cusick** - JPMorgan - Analyst

Two questions. We'll see how I do. So first on prepaid, tablets were up a little bit. And I wonder if you saw a little bit of a drag even though from the timing of the iPad launch and if things have gotten a little better since that has come through.

And then second, we've been getting a lot of questions about your ability to control iPhone subsidies. And maybe you can help us out a little bit. It seems like the way you control costs on this is raising upgrade rates and sort of pushing back on timing, rather than cutting down on the actual subsidy of that device. Is there a level of control you have on those subsidies over time, or are you pretty much stuck with the way things are priced today? Thanks.

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

First, on prepaid tablets, it is a great point. We did see a slowdown in the beginning of the quarter on the anticipation of the iPad 4G LTE device coming to market. And as you know, that was only about 2, 2.5 weeks of product in the marketplace. And we saw significant volume previous to any volume that we had previously seen on tablet sales.

So I think that going into the second quarter, that volume will continue. So, yes, there was a little bit of a downward demand in the beginning, waiting for the new iPad to come out. So again, I think we are off to a good start. We sold 390,000 tablets in the quarter. And, as we said, bulk of them were -- 60% were increase in tablet sales year-over-year. So I think going into the future, tablets will continue to be a very strategic segment of our business.

On the Apple iPhone, look, I think as I've said before, we look at every individual handset. We have a broad portfolio. We manage it handset by handset and manage our subsidy. And again, that is just one aspect of our P&L. And this is just a nature of this business that has grown from the beginning of the industry that said we subsidize handsets.

I do think, though, it is important that there is a third ecosystem that is brought into the mix here, and we are fully supportive of that with Microsoft. And as we said that we created the Android platform from beginning, and it is an incredible platform today that we helped create, and we are looking to do the same thing with a third ecosystem. So that is how I think that we plan to go into the future here.

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**Phil Cusick** - JPMorgan - Analyst

Thanks, Fran.

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**Operator**

Michael Rollins, Citigroup.

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**Michael Rollins** - Citigroup - Analyst

Thanks for taking the questions. Real quick, could we just get an update on the net debt at the Wireless level? And then taking a step back, can we get an update on what is happening in enterprise with the VDMS strategy that you are trying to roll out? And then anything else in terms of demand that you are seeing on video and how that is helping your enterprise business. Thanks.

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

On the net debt for Wireless, we had gross debt of \$10.9 billion, cash on hand of \$4.4 billion, so net debt at \$6.4 billion.



On the enterprise VES, I think we are making great progress with the new organization and the umbrella organization that John Stratton has over both Wireless and Wireline from an enterprise perspective. We have gone very deep into verticals. We see that there is -- and if you paid attention to Lowell's remarks here recently at the Healthcare Forum, we see a lot of healthcare opportunity and are engaging in a lot of partnerships to extend what we think is a really good product set on the reduction of overall healthcare costs in the nation, but also to deliver some really neat innovation-type ideas into the future of healthcare and how we manage that from an enterprise perspective.

As far as overall growth of the segment, we did see a decline this quarter in Europe. It was not expected, just to give you some baseline here. Last year, our European market was growing on average about 13%. It contributes about \$450 million of revenue per quarter. We saw that drop to flat this quarter. So there was a drastic pullback in our European market.

We don't believe that is long-term. We think that is more of a short-term issue. We already started to see some increased bookings here exiting the first quarter, but that probably won't turn into revenue for three to six months. As you know, this industry is a longer-term type recording from the time that you get an order. But I think this is a short-term issue for us, but it did put an impact on our overall growth.

Now having said that, our cloud services and our strategic nature of our security, those portfolios are growing well. Our overall cloud portfolio grew by 17% quarter-over-quarter, year-over-year. So I think we are making progress in the areas that we want to make progress in. But again, the portfolio rationalization is also creating a drag here. And as we continue down that path, we will lose some revenue in those less profitable platforms that we really want to discontinue investing in. But it is for the betterment of us and betterment of our customers to move them to a more highly innovative platform.

And then the last thing, of course, is the development and launch that we did last June of our VDMS platform. And we will be launching our next phase of that come this June, and we expect to see some growth revenue acceleration from that platform as we go here.

So there is a number of things that John is implementing that I think will contribute, as I said in my script here -- contribute to the future growth of the overall Wireline revenue top line and margin growth.

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**Michael Rollins** - Citigroup - Analyst

Fran, if I could just follow up on one more thing. What pushed Verizon Wireless over the edge to put the spectrum up for sale? Could you just address a little bit of the background to yesterday's announcement? Thanks.

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

So thanks for that question, and I think this is an example where people write articles where they don't have facts, so let's talk about the facts. Number one, we, as I think Verizon Wireless has shown over time that they are very, very good stewards of spectrum and efficient spectrum. And we are responsible and efficient owners of the spectrum, and as a company policy we would not hoard the spectrum.

Now when we bought this back in 2008, obviously we did not have the foresight to know that we would have an opportunity to acquire AWS spectrum from the cable companies. And if you look at our spectrum holdings, we purchased a 700 MHz, which is an extremely efficient, and this is where we built our LTE platform on.

And then we had the AWS spectrum in the East which was very efficient from an overbuild perspective on capacity of our LTE platform. And now with the deal that we have with SpectrumCo, we believe that is the most efficient for us to utilize and build out our LTE platform.

So hence, the lower 700 megahertz A and B does not fit as nicely into our spectrum holdings as it may for others. So we think it is the prudent thing to do to sell these licenses off to the rest of the industry for the benefit of their customers and to enhance their ability to build out 4G LTE.

So I think we would say that we are being good stewards. This has nothing to do -- we did not just wake up yesterday and decide we were going to sell spectrum because we ran into a roadblock at the FCC. That is continuing. We have facts that say the 180-day-clock is going and that we are still very confident that we will get approval for the AWS acquisition from SpectrumCo.

But just two other points I want to make here. Number one, this is contingent on us getting the AWS spectrum approved, because obviously, we would need this spectrum if that is not approved. And again, we think it is the right thing for the FCC and maybe a standard for them to use in the future of how spectrum should be allocated out and sold and efficient ownership and protocols.

The other thing is I think there were some articles written that this is going to be a fire sale. This is nothing near a fire sale. We bought this spectrum back in 2008, we've had carrying costs and we will be prudent to our shareholders to make sure we get a return on our investments. We know what the value of this spectrum is in the free market, and obviously, we are going through an auction to allow many different parties to participate through a third-party auctioneer.

And look, if we don't get the price that we think is a fair price, then we won't go through with the sale, and that is at our discretion. So I think there are some important facts, and I'll stop there. Thanks.

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**Operator**

David Barden, Bank of America Merrill Lynch.

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

Just maybe a couple follow-ups. First, Fran, on the AWS spectrum approval, is there a level of divestitures that the FCC could come up with that would be a dealbreaker from your perspective? Or is just getting kind of any magnitude of an AWS deal done sufficient?

And then with respect to the Wireless margin, you are targeting \$2 billion of cost cuts, I guess, for the year. If you could kind of share with us where we wound up after the end of first quarter on that.

And then the last one, if I could, is just could you kind of give us an update on what, if any, results have you been able to generate from your partnership with the cable companies on the selling of a joint product that have been material to the business? Thanks.

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

First, on the AWS approval, I think that we are exactly where we expected to be. The conversations are going exactly the way we thought. I am not going to speculate on caps or what we would do, what we wouldn't do. And I think what I will say is, look, we are exactly where we thought we would be and we think we will close this transaction by midsummer.

On the \$2 billion Wireless cost-cutting ideas, I think we have shown that we are very good executioners on the cost-cutting routines of \$3 billion in the last two years. The \$2 billion is a combination of a variety of things. You saw the announcement of some call-center rationalization. Obviously, part of this \$2 billion is to work on the reduction of our subsidies. And you are already seeing some of these plans go into action with our upgrade fee and some other things.

So there is a wide swath of cost-cutting initiatives that Dan Mead and his team are executing on. And right now, coming out of the first quarter, we are actually right on track where we expected to be.

And then lastly, on the cable companies, obviously, we are still in a trial mode. We are working out the kinks. We launched a couple markets here with Comcast up in Seattle and Portland. We just launched a couple new markets with Time Warner Cable. So I think it is too early to talk about



this one. The agreements are still in front of the DOJ and the FCC, and we continue to cooperate with them. And we will wait until the transaction closes and get up full to speed and then we will talk about that.

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

Great, guys. Thanks.

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**Operator**

Tim Horan, Oppenheimer.

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

Thanks. Good morning, guys. Fran, two questions, if you don't mind. On the enterprise business, on the core business, could you just give us maybe a little color around -- it sounds like you're saying that volumes are fine, pricing is fine and you haven't really seen a pick-up in competition. But obviously, these peripheral legacy products are in decline.

I just want to make sure that is kind of what you are saying. And maybe did you see any seasonality in core enterprise? Did you see maybe lower sales in December and that has kind of picked up? I know you kind of talked about Europe a little bit, but maybe just here in the US. And then I just had a CapEx follow-up.

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

As far as enterprise goes, look, I think the enterprise business is -- in our Strategic Services area is steady as she goes. We are growing that portfolio. And look, any time you go through a massive restructure like John has implemented at VES with going into more of a vertical type segment, you are going to have a little disruption within your front-line sales force, and I think we saw that.

But that was like a 60- to 90-day interruption, and I think we are getting back on pace, and we expect enterprise to start to get back on their feet here going into the second quarter and through the year.

And as far as the core side goes, the core is just steady as she goes. It is a declining business. People are moving away from the legacy voice and long distance and moving more into the IP technology. And this is where we have several of our customer base still on the legacy core platforms that we need to move off of so that we can stop investing in those platforms, and get them to something that is more innovative and more efficient for them as a company as well. I don't think they are surprised with the conversations that we are having.

So I think as we go here, this will be a steady course. And as we said before, our goal is to be a gross national product type growth here, GDP-plus type organization. So I think that is what we are striving for, and that is what John is striving for as well.

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

So it sounds like (multiple speakers). Just on enterprise, it sounds like you're really trying to accelerate the conversion over. How much longer do you think that would take?

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

Well, I think this is going to be -- on some of these legacy type platforms, this could be a two-year transition.



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

Great. And then on CapEx, is flattish a good number for the full year versus last year? I know that would decline you as a percentage of revenue at a fairly healthy pace, given what we have seen in Wireless.

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

Yes, I have said that the guidance would be -- we wouldn't give specific guidance, but flat is a good guidance.

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

Thank you.

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**John Doherty** - *Verizon Communications Inc. - SVP of IR*

Brad, let's take two more questions, please.

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**Operator**

Mike McCormack, Nomura Securities.

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

Fran, could you just make a comment -- on the ARPU side, obviously, pretty strong performance on the wireless ARPU. But it looked like voice -- the headwind on voice sort of became less of a headwind this quarter; pretty good improvement on the rate of decline. Just what you are seeing there, whether it is people just not pricing that down anymore, or what behaviors the consumers are showing you.

And then just a couple on the house-cleaning side. On Wireless D&A, it looked like it was down sequentially. Just wondering if there was a change in assumption there. And then on the Wireline margin commentary, the better year-over-year, I'm assuming that is on a reported basis. Thanks.

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

Mike, just a couple things here on the voice and text messaging. Our messaging revenue actually grew 4% again year-over-year, so we are not seeing what others in the international market have seen. And again, it all comes down to the way you package the bundle, and we still have a majority of our customers taking a bundled package of voice and text along with their data plan. So we are starting to see that starting to flatten out perspective.

But look, we keep our eye on this, and with 4G LTE and VoLTE coming at the end of this year into next year, there will be additional opportunities to convert more revenue from our voice products as we launch into more, if you will, IP type videoconferencing and so forth.

As far as Verizon Wireless depreciation and amortization, look, at the beginning of every year, we have a policy that we look at our asset base and reevaluate all of our estimated lives on all of our asset bases. And sometimes we make decisions to accelerate and sometimes we make decisions to re-evaluate the lives that we have on a certain asset. And we have done that this year, as we do every year, and in Verizon Wireless, there was a life extension on our entire EVDO platform.

But this is nothing unusual that we normally don't do, and so that is the answer to that one.



**John Doherty** - Verizon Communications Inc. - SVP of IR

Brad, let's take the last 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. Just to come back to the CapEx statement, in order for your CapEx to be flattish over the course of the year, it would seem like the spending would have to pick up a little bit in Wireless. First of all, is that correct conclusion? And if so, what would be behind that?

And the second question is to clarify a statement you made about margins. Fran, you mentioned getting to the third quarter of last year Wireless EBITDA margin, that was just inside 48%. Is that a point you think you can achieve once again at some quarter during the year, or is that actually a full-year target for Verizon Wireless?

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

As far as -- these are both guidance type questions, so I'm not going to get into the specifics of them. Look, we said we will be flat at CapEx and let's leave it at that. I'm not going to get into the individual components or quarter-by-quarter.

And then on the Wireless margins, I've said that, look, our goal is to get back to our 3Q margin, and we will strive to get there.

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**Brett Feldman** - Deutsche Bank - Analyst

Okay, thanks for the question.

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**John Doherty** - Verizon Communications Inc. - SVP of IR

Thanks, Brad. That concludes our call.

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**Operator**

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation and for using Verizon Conferencing Services. You may now disconnect.

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