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VZ - Q1 2013 Verizon Earnings Conference Call

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OVERVIEW:

VZ reported 1Q13 EPS of \$0.68.



CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

Jason Armstrong *Goldman Sachs - Analyst*

Simon Flannery *Morgan Stanley - Analyst*

John Hodulik *UBS - Analyst*

Michael Rollins *Citi Investment Research - Analyst*

Mike McCormack *Nomura - Analyst*

Brett Feldman *Deutsche Bank - Analyst*

David Barden *BofA Merrill Lynch - Analyst*

Jennifer Fritzsche *Wells Fargo - Analyst*

Tom Seitz *Jefferies - Analyst*

Tim Horan *Oppenheimer - Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Verizon first-quarter 2013 earnings conference call. At this time, all participants have been placed in a listen-only mode, and the floor will be opened 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. Michael Stefanski, Senior Vice President, Investor Relations.

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

Thanks, Brad. Good morning, and welcome to our first-quarter 2013 earnings conference call. This is Mike Stefanski, and I'm here with our Chief Financial Officer, Fran Shammo. Thank you for joining us this morning.

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. Replays and a transcript of this call will be available on our website later today.

I would also like to draw your attention to our Safe Harbor statement. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. Discussion of factors that may affect future results is contained in Verizon's filings with the SEC, which are 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 available on our website.

I'd also point out that the quarterly growth rates disclosed in our presentation slides and during our formal remarks are on a year-over-year basis, unless otherwise noted as sequential. There were no special items of a non-operational nature included in our reported earnings 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, Mike. Good morning, everyone. We entered this year with strong momentum and we are seeing our strategic investments driving an excellent start to 2013. Earnings per share of \$0.68 was up 15.3%. Our investment returns are improving and becoming more evident in our results.

Our strategic focus is on building networks and platforms as the foundation for innovation and growth. By investing consistently in these networks and platforms, we have positioned the business to take advantage of growth opportunities in the rapidly evolving markets for broadband, video and cloud services.

Our investments in 4G LTE enable us to provide a superior customer experience in wireless broadband and video. Our investments in fiber to the home enable a leading broadband and video experience to FiOS customers through higher speeds and capacity. Our investments in global IP, managed services, cloud computing, security and machine-to-machine enable our ability to serve the complex needs of large enterprise customers around the globe.

Our operational focus is on execution, which means performing the basics every day. In short, our approach is to meet customer needs by delivering products and services in the most efficient and effective way.

Our implementation of Share Everything plans is simplifying decisions for customers, making it easier to upgrade and add devices while eliminating the need for separate data plans for each device. Our FiOS Quantum offer and copper-to-fiber migration initiative are examples of improving service quality and increasing operational efficiency.

In enterprise, our ongoing retooling efforts, which include product rationalization and systems consolidation, will result in a more efficient and effective service delivery model. Verizon Lean Six Sigma principles are being adopted across the entire business, and we are beginning to see efficiency gains in many areas, including customer care, supply chain and systems support, to name a few.

As we move through the year, successful execution in our key strategic areas will drive incremental revenue and better operating efficiency, resulting in continued growth in free cash flows and earnings.

Let me shift now to our first-quarter performance, hitting a few highlights. Our Wireless results were strong, striking a favorable balance between growth and profitability. We added 677,000 retail postpaid connections, up 35% year-over-year. Service revenue grew 8.6%, and our EBITDA service margin was 50.4%, which was right in line with our guidance.

FiOS also had a strong quarter of customer and revenue growth. We added 188,000 new FiOS Internet subscribers and had 169,000 FiOS video additions. FiOS revenue grew 15.1% and ARPU was over \$150 a month.

In Global Enterprise, Strategic Services revenue continued to increase, up 6% year-over-year. Free cash flows in the first quarter increased \$1.5 billion or 64% on the strength of higher cash from operations.

Now let's take a brief look at consolidated results, starting with slide four. Total operating revenue grew 4.2%, sustaining our solid top-line growth performance. For the quarter, the increase in consolidated revenues, coupled with effective cost management, resulted in 19.8% growth in operating income. Consolidated EBITDA also grew at a double-digit rate, up 12.1%, while our EBITDA margin expanded by 240 basis points to 35.1%.

Now let's move into a review of the segments, starting with Wireless on slide five. Our consistent investment in Wireless drives our leadership in network quality, reliability and the overall customer experience. Five years ago, we committed to 4G LTE as the next-generation technology, and we have taken all the necessary steps to take advantage of this growth opportunity. These actions include securing necessary spectrum, allocating capital to deploy 4G LTE nationwide, fostering a robust device and application ecosystem and introducing a revolutionary pricing framework with

our Share Everything plans for consumer and small business. Once again, through solid execution of our strategy, the Wireless results speak for themselves.

We also knew that by taking advantage of the unique market growth opportunities in the fourth quarter, we would quickly realize the benefit. Our first-quarter results prove this out. Total Wireless revenues grew to \$19.5 billion and now represent two thirds of Verizon's consolidated revenue. Our strong momentum in terms of connections growth and smartphone penetration drove first-quarter service revenue growth of 8.6%.

As expected, profitability rebounded quickly following the high quality device activations of the fourth quarter. EBITDA grew to \$8.4 billion, up 18.1%, and our industry-leading EBITDA service margins expanded to 50.4%, up 410 basis points over the first quarter of 2012.

Let's now turn to a more detailed look at Wireless revenue and accounts, beginning on slide six. The increase in service revenue was driven by a combination of factors, including customer growth and increased smartphone penetration. The popularity and simplicity of our Share Everything plans is driving increases in both the revenue and number of devices per account.

During the first quarter, retail postpaid service revenue per account, or ARPA, grew to more than \$150 per month, an increase of 6.9%. Connections per account increased to 2.67, up 5.1%. In just nine months, 30% of our postpaid account base is on a Share Everything plan. Customers have quickly recognized the value of shared data across multiple devices.

In late January, we also introduced Share Everything plans for small business, which allow for up to 25 devices per account. In terms of the number of postpaid accounts, our Share Everything plans have resulted in consolidation of accounts. Let's take a closer look at connections growth on slide seven.

In the first quarter, we added 677,000 new retail postpaid connections, an increase of 35.1% year-over-year. Last year, postpaid connections increased sequentially each quarter, and we expect a similar pattern of accelerating growth in 2013. We have an industry-leading 98.9 million retail connections, with 93.2 million postpaid and 5.7 million prepaid. Our postpaid connections represent 34.9 million accounts.

Postpaid gross adds in the first quarter totaled 3.5 million, up 15.6% year-over-year. In terms of upgrades, 6.7% of our postpaid connections base upgraded during the quarter.

Our churn metrics continue to be market-leading. Retail postpaid churn was 1.01%. During the quarter, we implemented several process improvements in the area of bad debt collections related to our Lean Six Sigma initiative. These improvements resulted in an acceleration of involuntary churn, which we expect will be lower in future periods.

Now let's turn to slide eight and take a look at device sales and our progress in 4G LTE. In the first quarter, we activated 9.7 million postpaid devices, 87% of which were phones. Smartphone activations totaled 7.2 million, and 68% of these were 4G LTE. We activated 4 million iPhones; half of them were 4G LTE and the other half were 3G.

Our smartphone penetration increased to 61%, up from 58% at the end of last year. A key point of differentiation for us and incremental revenue is the improved mix of gross adds and upgrades within our smartphone activations. In the first quarter, gross adds or "new-to-Verizon" customers represented about 28% of the total smartphone activations, much higher than the 22% to 24% range we reported in the first half of 2012.

We also have incremental revenue opportunities with upgrades. About 38% of customers upgrading this quarter were buying a smartphone for the first time. I would also note that when customers upgrade from a 3G to a 4G LTE smartphone, they are usually in a shared data plan, enabling higher usage and additional device adoption, which ultimately drives higher revenue per account.

Customer adoption of 4G LTE continues to accelerate. At the end of the first quarter, 4G LTE phones and devices represented more than 28% of total retail postpaid connections. 40% of smartphones and 63% of Internet devices are now 4G LTE, and 54% of our total data traffic is already on the 4G LTE network, which is five times more efficient than 3G.



In terms of 4G LTE geographic coverage, we are by far the market leader. Today, our 4G LTE service is available in 491 markets, covering 287 million POPs, representing more than 95% of our 3G coverage. We will continue to leverage our advantage and expect that our 4G LTE footprint will effectively match our 3G network by the end of the second quarter.

Network quality and reliability will continue to be the hallmarks of the Verizon brand, and we will continue to invest to maintain our leadership position.

Let's move next to our Wireline segment, starting on slide nine. In Wireline, our investments in FiOS, global IP, security, cloud and machine-to-machine provide powerful platforms to deliver the services and leading-edge applications and solutions that our customers are looking for. These services are increasingly efficient, and in the long run, will help improve our cost structure.

In the Consumer and Mass Markets business, we continue to see positive signs, highlighted by 15.1% FiOS revenue growth this quarter. In addition to increasing FiOS penetration, we are focused on improving our operating and capital efficiency. We are also making good progress in our copper-to-fiber migration program.

In enterprise, we continue to see mixed performance. Our strategic service revenue grew 6%, but declines in core services like voice and data transport, as well as CPE, more than offset the increase.

In terms of Wireline profitability, first-quarter EBITDA was \$2.1 billion, and the margin was 21.4%, roughly flat sequentially if we set aside the impacts of Sandy in the fourth quarter.

As we have previously indicated, we do not expect much in the way of total Wireline EBITDA margin expansion in 2013. However, the continued strong performance of FiOS, our copper-to-fiber initiative and the benefits of new union contracts give us confidence that consumer and mass markets will contribute positively to wireline profit this year. In Enterprise, while growth in strategic services continues to improve the revenue mix, secular declines in both retail and wholesale voice and data transport services are putting pressure on wireline profitability. We believe that our ongoing product rationalization efforts, and other retooling efforts, will ultimately improve our cost structure, and result in a fundamentally stronger enterprise business. Looking ahead, we are positioned to improve the wireline margin in 2014 based on better contributions from our strategic investments, which include RedBox Instant, Hughes Telematics, and Verizon Digital Media Services. Let's take a closer look at the revenue components, starting with Mass Markets on Slide 10.

FiOS is the foundation of our growth strategy in the consumer market and it shows in our first-quarter results. Consumer revenues grew 4.3%, driven by increased FiOS revenue, which now represents 69% of consumer revenue. FiOS is also the key driver of growth in overall consumer ARPU, which increased to more than \$107 per month, up 9.5%. FiOS ARPU remains at over \$150 per month, and two thirds of our FiOS consumer customers are triple-play, with voice, Internet and video services.

As I highlighted earlier, FiOS customer growth was strong in the first quarter. In terms of broadband, we had 188,000 new FiOS Internet additions in the quarter and now have 5.6 million subscribers, representing penetration of 38%. Overall, net broadband subscribers were a positive 99,000, marking a sharp improvement over the past several quarters. In FiOS video, we added 169,000 subscribers in the quarter, bringing our total to 4.9 million, which is 34% penetration.

We continue to make steady progress upgrading copper services to fiber, increasing the number of upgrades each quarter. We are off to a strong start, converting about 83,000 homes in the first quarter, with a target of 300,000 for the year. This network evolution initiative is important for us as we systematically reduce our dependence on older technologies throughout the business. Aside from the obvious expense benefits and improvements in customer satisfaction, the conversion to fiber also provides customers the opportunity to purchase FiOS services, which could result in additional ARPU over time.

Another positive result in the quarter was the steady improvement in our residential connection trends. Retail residential connections declined by 5.6% compared with a loss of 6.8% at this time last year.



Let's move to our Enterprise Markets next on slide 11. In the first quarter, Global Enterprise revenue declined \$99 million or 2.6%. CPE sales, which we are deemphasizing, represented all of the decrease. Strategic Services, which comprise 56% of Global Enterprise revenue, totaled \$2.1 billion, up 6%. Continued declines in voice and data transport offset this increase.

In the enterprise market, we continue to work through economic challenges. We still see cautious behavior on the part of many enterprise customers in terms of new contracts and investment decisions. As we move through the year, we are hopeful that companies will be able to be more definitive about capital commitments and will renew their investing activities.

Moving next to Global wholesale, first-quarter revenues declined \$134 million or 7.2%, due primarily to continued declines in transport services. Again, our strategy is to better monetize our global IP network by driving a more efficient migration to next-generation ethernet services.

I would like to turn now to slide 12 to discuss our cash flow results. Our free cash flow in the first quarter was very strong. Cash flows from operations grew \$1.6 billion or 26.4%, and free cash flow increased to \$3.9 billion. Capital expenditures for the quarter were \$3.6 billion, essentially flat year-over-year. We remain focused on improving investment returns and capital efficiency, and we are expecting our CapEx-to-revenue ratio for the full year to decline.

In Wireless, capital spending totaled \$2 billion, up 5.7%. Within our overall spending outlook, we expect to allocate more capital to 4G LTE to further expand coverage and add capacity. With regard to capacity, we have started to incur some capital costs associated with the AWS spectrum, which we expect to deploy in our network later in the year.

In Wireline, capital spending was \$1.4 billion in the quarter, down 6.7%. Our balance sheet and credit metrics remain very strong. Our total debt at the end of the first quarter was \$52.9 billion. Net debt was \$47.4 billion, and our net debt to adjusted EBITDA ratio was about 1.2 times.

Let's summarize on slide 13. As we stated earlier, we entered 2013 with great confidence. Our strategic investments and operational execution drove a solid financial start to the year. We expect to sustain this positive momentum throughout 2013 and into 2014.

We are committed to driving shareholder value by executing our plans and improving the fundamentals of the business. Our focus is to capture incremental revenue growth in our key strategic areas. At the same time, we will continue to transform our service delivery and cost structure through the Verizon Lean Six Sigma initiative. As always, we will continue to invest in a disciplined manner, ensuring that we have the necessary platforms for innovation and growth. Through this strategy and execution model, we expect to drive cash flow and earnings growth.

Before I turn the call back to Mike, I want to take a moment to say a word about the tragedy that has unfolded this week around the Boston Marathon. Our thoughts and prayers are with the victims and their families. This is a very tough situation for so many people. We also want to thank our employees in the Boston area for their work and support of emergency personnel and law enforcement authorities. Verizon, of course, will continue to do whatever it can to help.

With that, I will turn the call over to Mike for your questions.

Mike Stefanski - Verizon Communications Inc. - SVP, IR

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jason Armstrong, Goldman Sachs.



Jason Armstrong - *Goldman Sachs - Analyst*

Thanks. Good morning. Fran, maybe a couple questions. First, on Wireless, a very good margin result this quarter. I guess when we think about the prior guide you had given, 49% to 50% margins for the year, I think a lot of people sort of worry that we will have good margins in the first three quarters of the year, only to give a lot of it back in the fourth quarter.

I guess related to this, last week you announced the intention to lengthen the handset upgrade cycle to 24 months. A couple questions. A, was that contemplated in this guidance? And then B, just given the timing of that, which I think kicks in in September, do you think that sort derisks the fourth quarter relative to the historical experience?

And then second question, I guess I will take a crack at the Vodafone question. There has been obviously a lot more noise recently on the future of that relationship. And I'm just wondering, is this the press and the analyst community really getting ahead of themselves, or has there been some sort of change related to the partners' desire and urgency to find a resolution? Thanks.

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

Thanks, Jason. Good morning, everyone. Look, on the 49% to 50%, if you recall back to what I said in the first quarter is we said that we expected Verizon Wireless, for the full year, to be within the range of 49% to 50%. Obviously, when I do something like that, I understand exactly what is on our plate of strategy for the year.

And we had said before that we look at all of our policies and procedures on a normal basis, and this was one of those policies that we knew we were going to change. And as you said, Jason, it is going to become effective September 1, and in essence what it does, it lengthens our upgrade cycle from the minus four months from contract equal to the contract, so full 24 months to be eligible for that upgrade.

So I think that is all factored in with what I have said coming into this year, and that is why I was confident with the 49% to 50% on the full-year basis.

With respect to Vodafone, obviously, we made a public announcement on April 2, and I would reference all of you back to that announcement. Of course, as we've always said before, we are very interested in acquiring the 45% stake in Verizon Wireless that we don't already own. I will say, though, that there has been a lot of speculation about the tax consequences of a purchase of this 45%, and we are extremely confident that such a transaction could be accomplished in a manner that is very tax-efficient and would not result in a tax on the gain in that stake.

So beyond that, I don't think there is really much else to say. So with that, I will pass it on to the next question.

Jason Armstrong - *Goldman Sachs - Analyst*

Okay. Thank you.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Good morning. Fran, a couple of quick things. On the enterprise, just any impact or comments on sequestration. Is that having any material impact on some of the comments you made about cautious spending?



And then onto quad-play. We've seen both in Europe and also with some of the comments out of DISH this week around focusing on bundling wireless with video and with other wireline products. You talk a lot about your triple play. You have the cable JV. Can you just give us your broader thoughts on bundling wireless more closely with some of the FiOS and other products, either now or down the road? Thanks.

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

Sure, Simon. Thank you. On the enterprise side of the house, obviously, we are seeing a lot of issues around enterprise. I think the sequestering has probably hit more of the government and state side of the house than it has the overall enterprise side of the house.

But on a much broader perspective around enterprise, obviously, we believe that our platforms are there. We're having good growth in the areas of our cloud and our network strategies. Our security is still growing at a good pace. But obviously, the voice and the data continue to offset this. And I don't really see a change there, given the fact that we really have not seen a consistent and steady economic growth profile. We have not seen a consistent and steady employment rate. I still think there is some uncertainty out there around what is going to happen with tax reform.

So, again, I believe that most companies are still in this cost-cutting mode, really not investing, but trying to get their P&L squared away. So until the overall macro economics change, I think we are going to be in this situation at least for the near term here.

And then on the quad play, obviously, we believe that the quad play is extremely important. That is why we entered into the cable agreement that we did a year ago, with the cross-selling agreements and also with the joint innovation that we have agreed to do. Because I think that this is very important, because as we look at how do we innovate and bring content in and outside of the home on a seamless perspective, this is where that all comes into play. And I think DISH has just again supported what we knew a year ago, which was this strategy is the right strategy.

The other thing I will say is that with this, it also supports the fact that you have a foreign investor who wants to come into the North American wireless footprint. You have a domestic investor who wants to gain share in the wireless footprint. This again just confirms our overall belief that the wireless industry still has a lot of growth left in it, both on the quad play and with the innovation of machine-to-machine and 4G LTE. So I think that is where we sit with the quad play.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Thanks a lot.

Operator

John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Thanks. Good morning, guys. Two quick ones. First, on the Wireline side, the wholesale revenue decline improved nicely for the last couple quarters. Is that really a function of the repositioning work you guys have done in VES, or are there some other more macro trends driving that? And can we expect to see that improvement continue?

And then over in Wireless, it looks like -- as I look at your prepaid and wholesale reseller numbers, it looks like prepaid was a little bit lighter than we thought, despite a price cut. Can you talk a little about -- and then you had stronger reseller numbers. Can you talk a little bit about your strategy in both of those categories and what we can expect going forward?



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

Sure, John. Thank you. So on the wholesale side of the house, this is just that -- I would tell you I believe that this is timing. And I think that if I had to predict what was going to happen the rest of the year, I think we are going to be around this 8% to 9% decline in wholesale. And it is mainly around, again, the drive behind volumes of voice and data.

And again, it points back to everything I talked about in enterprise, because most of the volume that we get on wholesale are people who resell that to enterprise customers and other customers for voice and data. So I agree with you, it has slowed a bit, but I think we are probably in a period of it is not going to improve here in the future.

As far as prepaid goes, I guess a couple things here. So as I've said before, in the prepaid market, we will look for niches to play that really complement what we want to be as a carrier in the prepaid market. And I've said before we are not going to chase the low end on our retail side of the house, but we will look for niches where we can make impact. I guess I would say this is the eighth consecutive quarter of a net add positive on our prepaid in retail.

As you said, John, we launched new pricing here in the first quarter. It was mid-first quarter so we don't really have the full impact of the quarter here on what we launched as smartphone pricing, which was the first time we launched a smartphone pricing on prepaid. We also launched a \$35 plan to really go after the basic phone category with a little bit of data in that.

So you are seeing us become -- I wouldn't say overly aggressive, but maybe a little bit more aggressive. But again, it ties into our network strategy of using the 3G network and keeping that network full because it contributes a lot of margin.

The other thing is, though, as I've said in the past, we will always play in both arenas between retail and wholesale, depending upon what drives the most value for Verizon shareholders. And you saw this quarter through a relationship that we have with one of our resellers with a distribution agreement to Wal-Mart, we added a 1 million net subs on that side of the house, which was really all prepaid subs.

So again, balancing out where we think the most favorable financial position is for us to get the greatest return, that is how you will see us going forward in the prepaid market.

John Hodulik - *UBS - Analyst*

Thanks, Fran.

Operator

Michael Rollins, Citi Investment Research.

Michael Rollins - *Citi Investment Research - Analyst*

Hi. Thanks for taking the questions. First, if you could just give us an update on the ending balance for Verizon Wireless net debt. And secondly, when we look at some of the numbers in the Wireless business, it looks like the postpaid customer device replacement cycle is lengthening. And I was curious if you could talk about the reasons for that. Do you think it is because of the policy changes you've made over the last couple of years? Are you seeing any resistance to some customers upgrading to the new shared plans that you've laid out? Just curious for some of your thoughts on that subject. Thanks.

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

All right, Michael. Thank you. So Verizon Wireless debt, gross is \$10 billion, cash is \$3.9 billion, for net of \$6.2 billion.

On the device line up, obviously, if you look at what we have done over the last two years, what we plan to do coming here in the fourth quarter, if you look at the ecosystem of these devices, these are highly subsidized devices, and we have to make sure that we position the value to Verizon and the value to our customer on an equal basis.

So what you seen over the last two years in modifying the policies to make sure that we can still offer a great lineup of phones at a reasonable price to our consumers for a two-year service contract, you are seeing us lengthen that cycle. And to be honest, I mean, we are not seeing a lot of resistance here. You have to understand that a lot of the upgrades were proactive by us, not by our customers. And so we are really just repositioning that the date of an upgrade is two years now instead of, say, 20 months.

We don't anticipate that there will be, obviously, a lot of dissatisfaction here, but we have to watch this carefully. Obviously, we want to give our customers the most choice that we possibly can. We think we have a great lineup. We have a lot of choices.

On the shared side of the house, we are not seeing resistance on people converting to shared. Actually, we are much ahead of what our expectations were. We have 30% of our base now on shared, and that continues go up. Also within the shared plan, we are seeing exactly what we thought would happen, is as people move to 4G -- and you heard that 69% -- or 68% of our upgrades are to 4G -- that is driving usage, which is also driving up to the higher tiers, driving the revenue profile, and also the connected devices.

As we said the last call, we see that when people come in as a new Verizon customer, their actual device attachment is much lower than our base. But over that nine to 12 months, we see them attaching more devices and moving up to where the average of our overall base is.

So we continue to see that happening, and it is all about customer service as well, not just when an upgrade period is. So I think we are hitting on all cylinders here, but we have to watch this carefully.

Michael Rollins - Citi Investment Research - Analyst

Thanks very much.

Operator

Mike McCormack, Nomura.

Mike McCormack - Nomura - Analyst

Hey, guys, thanks. Just wanted to circle back on the upgrade policy and your thoughts as the year progresses. There has been a view that we should have some of your competitors getting a little bit healthier towards the back half of the year. Does that set up to be another differentiator for those other carriers?

And then secondly, on the upgrade policy change, is there a risk, as the customer matures past the 20 months, that the ETF is low enough that it could create unnecessary churn for you guys?

And then lastly, just thinking about data usage, and obviously it's an important thing for ARPA revenue growth. How much of that, if you can measure it, is being offloaded onto the WiFi network, onto the wireline data side, to maybe either try to save data usage on the wireless side or to get a better customer experience? Thanks.



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

Hi, Mike. Thanks. So on the upgrade policy, I mean, obviously these decisions from us are done based on a lot of customer input and customer feedback and focus groups. So we don't just jump into these things. You saw us do that when we implemented the \$30 upgrade fee. So we are very diligent in how we do this.

As far as customer contracts and ETFs, we managed this since we started with service agreements in 24 months. So this is nothing new. And, look, I think we compete on a number of fronts. It is not just on a service contract or pricing. We compete on our outstanding network. So when you look at our network and reliability, the 4G network and our superiority, I think if you compare our network with others, that you would have to say we are the leader in the market as far as reach, as far as consistency of performance. So when you go to connect that data session, it connects, you get the speed that we advertise, on a consistent basis. If you look at the Share Everything plan and the options we have there and the flexibility within that plan. If you look at the number of our device lineups.

So all of this, including our great customer service from our customer service centers, this all goes into why our churn is the lowest in the industry and will continue to be the lowest in the industry. And this is what we work for every single day. It is tackling the basics, as I said in my opening comments.

So again, we manage all of this. As far as data and offload to WiFi, obviously, customers offload to WiFi. But what we see is, again, because of the superiority of our network and because of the authentication that our network has, we actually want people to offload when they are in their homes. But when they are out in public areas, they want to stay on our network because it is authenticated, it is secure, and a lot of WiFi networks outside of the home are not secure. So I think that plays into that as well. But we do think that WiFi is a good offload in certain circumstances, but not all.

Mike McCormack - *Nomura - Analyst*

Fran, just quickly on cost of service in Wireless, it had a meaningful step down, which obviously is a credit to your cost-saving opportunities. But how should we look at that progressing through the year?

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

Well, I think that all hinges on the upgrade. So when we came into this year, I said that our upgrades would be flat with a year ago, so, obviously, sequentially if that is -- I think that is what you are looking at -- it is a considerable decrease because of the volume that we had in the fourth quarter versus the first quarter.

Mike McCormack - *Nomura - Analyst*

Okay, great. Thanks.

Operator

Brett Feldman, Deutsche Bank.

Brett Feldman - *Deutsche Bank - Analyst*

Thanks for taking the question. Fran, you noted the importance of keeping a close eye on the level of subsidies that you incur, and that is why you made further adjustments to the upgrade policy. So if we look at the policies now, people have to keep their phone for the duration of their contract, they have an upgrade fee. It seems like you've done just about everything you can do from a policy standpoint to keep subsidies in line.



Are there any other steps you can take as a carrier to work on that even further? For example, are you rethinking whether you should be favoring lower subsidized phones in the stores? Or is there even anything you can do to influence the actual cost of the manufacturing of phones that it is lower for you?

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

Thanks, Brett. Around this, again, I go back to if you look at the history of basic phones and what happened over time, again, I think the smartphone category will also follow this, where as the competition and innovation, as new phones come to market -- obviously, BlackBerry is coming back into the market, we have the Windows phone -- so as more ecosystem comes here and more competition happens, the cost of these phones will eventually start to decrease. And we've already seen some of this competition happen in certain categories with the decrease of smartphones. We've launched smartphones in prepaid. That gives you an indication that there is some low-end smartphones out there, because we really don't subsidize much on the prepaid product.

So again, as the ecosystem builds, I think this will follow what historically the basic phone did over the last 10 years that that was maturing. And that is what is going to impact the lower subsidies over time.

And of course, then, as I've said in the past, as we move into our 4G and our VoLTE launch -- which we will start to have VoLTE-capable phones by the end of this year, we will commercially launch early next year -- and as we do that and our footprint of 4G LTE really covers that of the 3G network and the experiences there, then we will start to take the CDMA chip out of those handsets. So again, that will impact subsidy going forward.

So I think we have a good road map here that says our strategy, we believe that we can start to reduce subsidy over a length of two to three years. So I think that is where our position is.

Brett Feldman - Deutsche Bank - Analyst

And was there any experience that you had with feature phones where you found that you had the ability to push the ecosystem? In other words, do you think there is any opportunity to start driving customers towards smartphones that already have lower subsidies, or do you really have to wait for the market to want those devices?

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

Well, I think, again, this goes back to customer satisfaction. And as I've said before, we don't incent our front lines to sell one phone over another. This is a customer choice. Because, again, the worst thing that can happen to us is force a phone into a customer's hands, and within our return policy of 14 days worry-free, they can come back and return that phone for dissatisfaction for any reason, and we give them a new phone. That is not a good financial model.

So we want the customer, when they walk out the door, to have the right phone in their hand, whatever phone they choose, and to make sure that they are educated to use that phone. So that is what is more important to us, instead of locking them into a low subsidy handset that they are going to be dissatisfied with.

Brett Feldman - Deutsche Bank - Analyst

Just a point of clarification, because you mentioned about eventually taking CDMA chipsets out of devices. What is the commitment to CDMA and what would be the timeframe for getting there?

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

Again, I think that it's going to come into play in 2014. So we will keep posted on that. But the strategy is to eventually, within these 4G LTE devices, to remove that chip at some point in time. So I think that is where we are at.

Brett Feldman - *Deutsche Bank - Analyst*

So we'd see our first device that doesn't necessarily have a CDMA chip next year, not all devices?

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

That's correct.

Brett Feldman - *Deutsche Bank - Analyst*

All right. Thank you.

Operator

David Barden, Bank of America.

David Barden - *BofA Merrill Lynch - Analyst*

Thanks for taking the questions. I guess first, Fran, it is probably going to become clearer, I think, through the quarter that you guys took another healthy chunk of the Wireless market share for net add growth. Could you talk a little bit about, as we think about the year unfolding, where this net add growth is coming from in terms of tablets, home zone, the share that you are winning from the iDEN network shutdown over at Sprint, just so we could kind of think about how the market is unfolding and where the competitive tangent points are?

And then I guess second, on the cash flow front, it looks like you guys didn't actually pay taxes this quarter, which was a big tailwind for that number. Could you give us a little more color about how you think that cash tax line is going to contribute or not to the cash flow picture for the rest of the year? Thanks.

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

Thanks, David. First on the all categories growth, so as I said in my prepared remarks here, as last year we came into the first quarter, I said that we would look at continuing to accelerate our growth through the year, and I think we are on plan to do that again this year.

As far as the mix of growth here, it is really evenly spread among all devices. So we had net gains in smartphone customers, we had net gains in our home phone connect product, we had net gains in Fusion, tablets, Internet devices, prepaid. So it is across the gamut that we are driving on every single device. So it is not one device over another, but we think that we will continue to grow each individual category on a net positive basis.

As far as cash flow goes, there is all kinds of things that happen in cash taxes during the quarter. We pay a lot of property tax and a lot of sales tax. There is a federal estimated tax that is in the first quarter. So again, I think that is included in maybe some separate line items that you're not seeing. But we did make some cash tax payments in the first quarter.



David Barden - *BofA Merrill Lynch - Analyst*

Okay, we'll follow up. Thanks.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - *Wells Fargo - Analyst*

Thank you. Most of my questions have been answered, but I just wanted to ask on spectrum. It was recently reported that the DOJ supports restricting the purchase of broadcast spectrum by limiting those current holders of low-band spectrum, such as yourselves. There isn't a lot of spectrum, in my view, coming over the next few years. You are clearly in a good position with AWS. But how do you handle spectrum needs, and how will this impact your CapEx or small cell deployments going forward?

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

Thanks, Jennifer. I think it is an important question, so let's just back up a second. So the FCC right now is targeting 2014 for the auctions, and is working to develop the rules around the auction process. Obviously, we are working very closely with the FCC and the broadcasters and others in the industry to develop the rules around these auctions and make them successful.

Really, our basis is we want to ensure that the FCC develops and implements the auctions in a way that allows Verizon Wireless to bid for and acquire the additional spectrum that it needs to run its business. As you know, the FCC, they need to maximize the amount of spectrum available for mobile broadband services and ensure that the auction is designed to encourage the broadcasters themselves to participate.

These rules that restrict companies from bidding and give other companies priority could actually cause the auction to fail. So, as you know, the DOJ recently this week weighed in on a theoretical concern about the market foreclosure. We believe the concern is really around some who buy the spectrum to keep others from buying the spectrum, and I think if you look at history, that has not shown itself. Verizon has never purchased spectrum for that reason. We buy it to use it, and I think our track record is we really efficiently -- we efficiently use the spectrum that we have. And I think the secondary market is another important one here, because we proved that the secondary market works in 2012 by divesting of some of the spectrum that we felt others could use more appropriately than we could.

So I think this all goes into that, but I think that is our view around the DOJ, and we will work closely with the FCC in order to make that spectrum available for the people who need it.

So as far as CapEx and utilizing what we need, obviously, we are in a very good position with spectrum. And as I said before, when spectrum comes up, whether it's in an auction or for sale in the open market, you have to be opportunistic, because it normally only comes up at one time. And we are very selective on what we go after, but we have a very long-term strategy with spectrum and we will be opportunistic if the climate presents itself.

Jennifer Fritzsche - *Wells Fargo - Analyst*

Great. Thank you, Fran.

Operator

Tom Seitz, Jefferies.



Tom Seitz - *Jefferies - Analyst*

Thanks. A couple of questions related to the copper-fiber migration. First, it looks like you are a little bit ahead of plan. Is that just a function of fixing Sandy issues immediately, or do you think you can keep or even accelerate this pace?

Second, you disclosed, I think, 83,000 forced conversions. Can you give us some idea of how many took just the voice product versus how many stepped up and took broadband and/or video?

And then finally, are there any states with regulatory hurdles or rules that are acting as governors on this initiative?

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

Thanks, Tom. So just a couple things here. So around the copper-to-fiber migration, so obviously, with this one, we did have very, very good process this quarter in converting these migrations. And some of this obviously had to do with some of the Sandy impact. I would also tell you, though, this is really a technology change, and we need to really move to the new technologies.

From a regulatory standpoint, if you look at it, the FCC has long-standing rules in place that permit copper retirement. Now, I know some of the CLECs have urged the FCC to suspend or change these rules. But we need to encourage our customers and others to move to the new technologies in order to provide our customers with the best solutions that they have.

And for many of our customers, that service is best delivered over fiber or even maybe a wireless network. And in some of these situations, we are not going to rebuild the copper. It doesn't make financial sense to lay fiber to some of these remote areas. So wireless may be a better solution here, and we are working with the regulatory agencies on that. And within Pennsylvania, a year ago, we solved some of the Internet provisioning via LTE instead of fiber.

So I think the regulatory bodies are very open to it; we continue to work with them. But as far as the copper-to-fiber migration here for the first quarter, I think we are off to a great start. And 300,000 is our target; that doesn't mean we can't exceed that. But we will continue to migrate our customers to the new technology.

As far as the breakdown between voice and Internet, we really don't despair there, because what is happening is as we move people over to fiber, they are coming onto the Quantum product. 27% of our base now is on Quantum. And what we are seeing is they are buying up in the tiers, because once they get that 15-, 30-meg tier, they are buying up to the 50-meg tier. And that is what is helping to drive the stellar revenue performance in the consumer market of 4.3%, which is the highest I think we've ever had at this point, compared to some of the prior years, and consistent with what we performed in last year.

So I think we are on a good path here to continue to produce solid Wireline consumer revenue growth with our strategy that we laid out. So thanks, Tom.

Tom Seitz - *Jefferies - Analyst*

Thank you.

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

We have time for one last question.



Operator

Tim Horan, Oppenheimer.

Tim Horan - Oppenheimer - Analyst

Thanks, guys. Around Wireless, I had a few questions, Fran, if it's okay. As part of moving to the 24-month cycle, I would assume there is a lot of variables to that. But it would seem to me that shared data plans are helping that out a lot. Maybe can you talk a little bit about the data usage on those shared data plans, the growth rate, or any other metrics you could provide?

And then also, on the phones, it just seems like the phones are getting a lot better. I know in my own family, we used to break phones after 12 months; now they seem to be lasting a lot longer. Was that part of the thinking? And just related to that, both personally and professionally, are you flexible at all on the 24-month upgrades? Will you provide 20-month upgrades for high-quality customers who are maybe getting a lower subsidy phone, or how rigid is that? Thanks a lot.

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

Thanks, Tim. On the 24-month cycle, obviously our policies are our policies, and obviously, I'll let Verizon Wireless deal with any exceptions to those policies at the front line. Because, again, we want to make sure that customers are satisfied, but the policy is the policy, and we make the -- we want to make sure that the front line sticks to our policies. But obviously, again, as you know, there is always an exception to the rule here and there.

As far as really thinking this through, I think that these are highly subsidized phones. These are miniature computers walking around. People -- it really goes to when you look at the demographics of the customers who upgrade, demographics play a big role in this. The younger generation wants to update to the day. Some others will hold their phones for three, even four years. So it really is a vast difference, and we are just trying to conform everything to a consistent policy so that it makes sense for the customer and it makes sense for us.

As far as 4G LTE and data usage, as we said, 54% of our data now is going over the LTE network. So that should tell you something about the usage of our 4G LTE customers. Beyond that, we are not going to disclose any individual statistics around data usage. So again, thanks, Tim, for the question.

Tim Horan - Oppenheimer - Analyst

Thank you.

Mike Stefanski - Verizon Communications Inc. - SVP, IR

I want to thank everyone for joining us today, and Brad, we can conclude the call.

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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