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VZ - Q2 2013 Verizon Earnings Conference Call

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OVERVIEW:

VZ reported 2Q13 GAAP EPS of \$0.78.



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PRESENTATION

Operator

Good morning and welcome to the Verizon second-quarter 2013 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. Michael Stefanski, Senior Vice President Investor Relations.

Michael Stefanski - Verizon - SVP of IR

Thanks, Brad. Good morning and welcome to our second-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.



Before Fran takes you through the details, I would like to make you aware of a nonoperational item included in the quarterly results. For the second quarter, we reported earnings of \$0.78 per share on a GAAP basis. These results include \$147 million after-tax or \$0.05 per share for the favorable effect of an interim actuarial remeasurement associated with one of our pension plans due to settlement accounting. The non-cash credits were due primarily to an increase in the discount rate assumption used to determine our current pension liability. On an adjusted basis, EPS was \$0.73 compared with \$0.64 a year ago.

Our discussion of consolidated results and growth rates in this presentation exclude the effect of the nonoperational gain. In addition, the quarterly growth rates disclosed in this presentation are on a year-over-year basis unless otherwise noted as sequential.

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

Fran Shammo - Verizon - EVP and CFO

Thanks, Mike. Good morning, everyone. Our strategic investments in 4G LTE, FiOS, global IP, and cloud services continue to drive strong operating performance. We are executing well in these key growth areas. Overall, consistent topline growth along with a strong focus on cost efficiency and profitability resulted in double-digit growth in operating income and earnings per share in the second quarter. In fact, we have posted double-digit earnings growth in five of the last six quarters.

Second-quarter adjusted EPS was \$0.73, up 14.1%. Year-to-date, adjusted earnings per share were \$1.41, representing 14.6% growth. As you know, our strategic focus is on building networks and platforms as the foundation for innovation and growth.

Underpinning our success is the consistent investment in these networks and platforms, which position us to take advantage of growth opportunities in the rapidly evolving Wireless and Wireline markets for broadband, video, and cloud services.

Operationally, we are focused on increasing value by delivering products and services to customers in the most efficient and effective way possible. In Wireless, our Share Everything Plans are a great example. We have simplified decisions for customers, making it easy to add new devices and manage their shared data usage.

Our FiOS Quantum offer, where customers can upgrade broadband speeds themselves, is another example of improving service quality and increasing operational efficiency. Throughout the entire business, there are many examples where Verizon Lean Six Sigma principles are being adopted and we are realizing efficiency gains in a number of areas, including customer care, supply chain, and system support.

As we move through the year, we are confident that successful execution in our key strategic areas will continue to drive incremental revenue and promote operating efficiency, resulting in sustainable growth in free cash flow and earnings.

Let me shift now to our second-quarter performance, hitting a few highlights. Our Wireless results were strong, once again effectively balancing growth and profitability. We added 941,000 retail postpaid connections, up nearly 40% sequentially. Service revenue grew more than 8%. EBITDA growth was up double digits and our EBITDA service margin was 49.8%, solidly within our annual margin guidance.

We also had a strong quarter of customer and revenue growth in FiOS. Revenues were up nearly 15% and we added 161,000 new subscribers in FiOS Internet and 140,000 in FiOS Video, roughly 20% more than we added in the second quarter last year. In Global Enterprise, strategic services revenue grew 4.8%.

Our consistent operating performance together with disciplined capital spending is driving higher free cash flow. Through the first half of the year, free cash flow increased by more than 20%, resulting in an improving return on investment profile for the entire business.

Now let's take a brief look at consolidated results, starting with slide four. Total operating revenue grew 4.3%, sustaining our solid topline growth performance. For the quarter, the increase in consolidated revenues coupled with effective cost management resulted in an 11.8% growth in

adjusted operating income. On an adjusted basis, consolidated EBITDA increased to \$10.5 billion and our EBITDA margin expanded by 90 basis points to 35.1%.

Now let's move into a review of the segments starting with Wireless on slide five. We have emphasized that consistent investment in Wireless drives our leadership in network quality, reliability, and the overall customer experience. Our commitment to 4G LTE covers a wide range of activities, including the securing of necessary spectrum, the allocation and deployment of capital for both coverage and capacity, our leadership in fostering a robust device and application ecosystem, and the success of our Share Everything Plans in driving device adoption and stimulating usage.

Once again, our second-quarter wireless results demonstrate the effective execution of this strategy. Total Wireless revenues grew to \$20 billion, presenting 67% of Verizon's consolidated revenue. We sustained strong service revenue growth of 8.3% making it the third consecutive quarter of growth in excess of 8%.

EBITDA increased to \$8.5 billion and our EBITDA service margin expanded by 80 basis points year-over-year to 49.8%, representing another very strong quarter of growth and profitability.

Let's now turn to a more detailed look at wireless revenue per account beginning on slide six. Service revenue growth continues to be driven by increasing connections, smartphone penetration gains, and data usage. The simplicity and value proposition of our Share Everything Plans is driving device adoption and stimulating higher usage, resulting in increases in both the number of devices and revenue per account.

During the second quarter, retail postpaid service revenue per account, or ARPA, grew 6.4% to \$152.50 per month. We have 35 million postpaid accounts and the average connection per account increased to 2.7, up 5.5%.

Our Share Everything Plans have been very successful. The plans have been available since June 28 of last year and customer adoption has been very strong. In just one year, more than 36% of our postpaid accounts are on a Share Everything Plan. The value proposition is simple and straightforward and customers increasingly recognize the value of shared data across multiple devices.

Let's take a closer look at connections growth on slide seven. As I highlighted earlier, we added 941,000 new retail postpaid connections, up from 677,000 in the first quarter and about 6% higher than a year ago. We also added 97,000 retail prepaid connections, so our retail net connections totaled just over 1 million in the quarter.

As I stated on our last earnings call, we expect to continue to see sequential quarterly net add improvement in 2013.

Total retail connections topped the 100 million mark in the quarter. Our industry-leading postpaid base stood at 94.3 million and we have more than 5.8 million prepaid connections.

Our connections growth was driven by another strong quarter of gross additions. Postpaid gross adds of 3.6 million were up 14.2% year-over-year. The number of customer upgrades also increased both sequentially and year-over-year with a postpaid upgrade rate of 7% for the quarter. We continue to expect that our annual upgrade rate will be about the same as last year. Our upgrades remain high quality with 36% of customers purchasing a smartphone for the first time.

We also maintained a high-quality mix within our postpaid net adds. We added 472,000 in the phone category. Of this total, 974,000 were smartphones with the balance representing the decline in basic phones. We added 371,000 Internet devices including tablets. The balance of just below 100,000 included Home Phone Connect, Home Fusion, and other connected devices.

Our churn metrics continue to be market leading. Retail postpaid churn was 0.93%. The sequential improvement was due primarily to an expected reduction in involuntary churn as discussed coming out of the first quarter.

Next, let's turn to slide 8 and take a look at device sales and our progress in 4G LTE. Postpaid device activations totaled 10.1 million in the quarter, representing both a sequential and year-over-year increase. We had a high-quality device mix once again with 88% of the activations being phones.

Smartphone activations totaled 7.5 million and 72% of them were 4G LTE. The smartphone mix was fairly balanced; roughly 51% of the activations were iPhones. Our smartphone penetration continued to improve and we ended the quarter at over 64%.

We had another strong quarter for Internet devices. Activations of these devices, which include mobile hotspots, jet packs, and tablets, topped 1 million again this quarter.

Adoption of 4G LTE smartphones and devices continue to accelerate. One-third of our retail postpaid connections are now 4G LTE compared to just 12% one year ago. 46% of our smartphones and more than two-thirds of our Internet devices are 4G LTE. Currently 59% of our total data traffic is carried on the 4G LTE network, which is 5 times more efficient than the 3G network.

In terms of geographic coverage, we now cover 500 US markets with 4G LTE and have essentially completed our buildout by matching our 3G footprint. Our LTE network covers more than 99% of our 3G footprint and when you include our Rural America Partners, LTE is available to about 301 million people across the nation.

Throughout the rest of this year, we will continue to invest, adding capacity to our existing 4G coverage, ensuring that customers are receiving the quality and consistent reliability that they expect from our network and devices. I will cover our capital spending outlook in more detail during our discussion of cash flows.

Let's move next to our Wireline segment, starting on slide 9. Our Wireline investments in platforms such as FiOS, global IP, security, cloud services, and machine to machine enable us to deliver the services and leading-edge applications and solutions that customers want. As these services scale, they will become increasingly efficient and will help improve our cost structure in the long run.

Total Wireline revenues decreased 2% in the second quarter as growth in FiOS and strategic services were offset by softer global enterprise and wholesale revenue from legacy transport services and CPE.

In terms of Wireline segment margin, second-quarter EBITDA increased to \$2.2 billion and the margin was 22.2%, up 80 basis points sequentially. We continue to believe we can improve the Wireline segment margin in 2014.

Let's take a closer look at the revenue components starting on slide 10. In the consumer and mass markets business, we continue to see positive signs, highlighted by sustained FiOS revenue growth. Consumer revenues grew 4.7%, driven by FiOS, which now represents 71% of consumer revenue. Our overall consumer monthly ARPU increased 9.4% to more than \$109 and we sustained a blended FiOS ARPU at over \$150 per month. Two-thirds of our FiOS customers are triple play, which have a higher amount of recurring revenue per month.

As I highlighted earlier, we had a good quarter of FiOS customer growth. In terms of broadband, we had 161,000 new FiOS Internet additions and now have 5.8 million subscribers, representing penetration of 39%. Overall, net broadband subscribers were a positive 45,000.

In FiOS Video, we added 140,000 new subscribers in the quarter, bringing our total to 5 million, which is over 34% penetration. In addition to the customer growth and increased penetration, we are also gaining traction with our FiOS Quantum offers for higher broadband speeds. Sales of our FiOS Internet product at speeds in excess of 50 megabits per second increased during the quarter and existing customers continue to buy up in the speed.

At the end of the quarter, one-third of FiOS Internet customers subscribed to Quantum, with speeds ranging from 50 to 300 megabits per second.

We continue to make steady progress with copper migrations, increasing the number of service upgrades each quarter. During the second quarter, we converted more than 86,000 customers. Through the first half, our total was 169,000. So we are more than halfway through our target of 300,000 for the year. This network evolution initiative is important for us as we reduce our dependency on older technologies.

Aside from the maintenance expense savings and improvements in customer satisfaction, conversions to fiber also provide 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 5.2% compared with a loss of 6.6% at this time last year. We expect that continued strength of FiOS, the copper migration initiative, and the benefits of labor contracts and work rule flexibility will have a positive effect on Wireline profitability this year.

Let's move to our enterprise markets next on slide 11. In the second quarter, Global Enterprise revenue declined \$184 million or 4.8%. CPE sales, which were down 34% year-over-year, represented \$162 million of the decrease. Excluding the decline in CPE, Global Enterprise revenue was down less than 1% on a year-over-year basis.

Strategic services, which now comprise 57% of enterprise revenue, grew 4.8%. In the second quarter, the continued decline in legacy transport services more than offset the growth in strategic services.

We continue to work through economic challenges in the enterprise space. Many of our customers are focused on improving their cost structure, which can result in reduced services with us. In addition, many customers continue to be cautious regarding new investment decisions.

Moving next to Global Wholesale, quarterly revenues declined \$141 million or 7.7%, due primarily to continued declines in the transport services. Again, our strategy is to better monetize our global IP and fiber network by driving a more efficient migration to next-generation Ethernet services.

In terms of profitability, while growth in the enterprise strategic services is improving the revenue mix, volume declines in the rest of Global Enterprise and wholesale continue to put pressure on Wireline margins. Through our Verizon Lean Six Sigma program, we are making good progress in our cost restructuring programs and retooling efforts, which we believe will improve our operating efficiency.

Let's turn to slide 12 for a discussion of our cash flow results. Our cash generation remained very strong. For the first half of the year, cash flows from operations increased by 12%. Free cash flow was up by more than 21%. Capital expenditures for the quarter totaled \$4 billion and were \$7.6 billion year to date, up 2.5%. Wireless capital spending in the second quarter totaled \$2.3 billion. Through the first half, Wireless CapEx totaled \$4.3 billion, 8.6% higher than last year.

As I noted earlier, we have essentially completed our initial LTE buildout by matching our 3G footprint. Throughout the rest of the year, we will continue to invest by adding capacity to our existing coverage as we begin to deploy AWS spectrum throughout the network.

In Wireline, capital expenditures totaled \$1.5 billion in the quarter and \$2.9 billion year to date, which was down 5.9% from last year. Strong connections growth driven by 4G LTE and our Share Everything Plan has resulted in higher demand forecasts and the need for increased capital investment. As such, we are increasing our full-year capital spending outlook from flat at \$16.2 billion to between \$16.4 billion and \$16.6 billion.

We remain focused on improving investment returns and capital efficiency and we continue to expect our CapEx to revenue ratio for the full year to improve even with the additional investments in 4G LTE.

Our balance sheet and credit metrics remain very strong. Total debt at the end of the second quarter was just under \$50 billion and our net debt to adjusted EBITDA ratio was about 1.2 times.

Let's summarize on slide 13. Our second-quarter results showed consistently good performance in the key strategic growth areas, so at the halfway point, the key year-to-date financial and operating metrics were strong -- consolidated revenue growth of 4.2%, operating income up 15.6%, adjusted earnings of \$1.41 per share, representing 14.6% growth.

In Wireless, service revenue growth up a very strong 8.4%; average revenue per account up 6.7%; retail postpaid additions of 1.6 million, up 16.5%; EBITDA growth of 14%; and an EBITDA service margin of 50.1%. We are on track to deliver on our 49% to 50% margin guidance for the full year.

In Wireline, consumer revenue growth of 4.5%, driven by FiOS growth of nearly 15%, 349,000 new subscribers in FiOS Internet and 309,000 in FiOS Video. We are on track to meet our 600,000 plus FiOS customer growth target.



Free cash flow generation is up better than 20% year-over-year and our balance sheet remains very strong. All in all, a very good first half. We are now focused on continuing the momentum, which should result in a strong second half of the year.

With that, I'll turn the call back to Mike so we can get to your questions.

Michael Stefanski - Verizon - SVP of IR

Fran, thank you. Brad, we are now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst

Thanks for taking the call. I guess two around Wireless. First, you talked about sequential improvements in adds in the third and fourth quarter. Given that Sprint is not going to be ceding a number of I-DEN subs into the market in what is traditionally not a strong third quarter, can you help us see why you are more confident there?

Second, can you talk of how you expect margins to track through the rest of the year? Given the upgrade comment you just made about being flat year-over-year, that's a little higher than I would've thought given the commentary or the change for the fourth quarter. Can you just talk about those? Thanks.

Fran Shammo - Verizon - EVP and CFO

Sure, Phil. Thank you. Good morning. So on the sequential third and fourth quarter, it's similar to the trend that we saw last year when coming out of the first and second quarter. I said we would potentially continue to see growth in the third and fourth quarter and again this is around what we expect the roadmap to be on additional device launches throughout the third and the fourth quarter. But the momentum that we have and you see that momentum coming out of second quarter -- and I will talk more to that in a second when we get to the margins -- we continue to see this high-quality subscriber coming onto the Wireless 4G LTE network and we don't see that changing at this point.

From a Sprint and porting ratio, I won't get into specific individual carriers, but again pretty consistently positive with all carriers from a porting ratio perspective.

On the margin side of the house, I think we have to put this in perspective. So again, we are fully engaged on the 49% to 50% guidance that I gave to you in the beginning of the year and if you look at the first half of the year at 50.1% for the first half and coming out of this quarter at 49.8%, I think you have to look at what's behind that.

So if you look at on a year-over-year basis just between the quarters, we improved our profitability by 80 basis points. In that, if you look at that, we moved 7.5 million smartphones; 1.6 million of that was additional smartphones over last year. Then if you just look at the 4G devices, we moved 3.1 million more 4G devices this year than we did a year ago.

And in that, if you look at the service revenue growth of 8.3%, that's up 100 basis points over where we were last year. So you can see the quality of these adds and if you take what we added in the quarter of net with 472,000 net phone, it's a pretty good indication of what we are going to drive from a margin perspective.



Then if you look at the network side of this with 4G LTE, we now have 33% of our customers on that network, 36% of our customers on Shared. We had a growth of 5.5% in the connected devices and I've said that our growth is really dependent upon two things. Number one, the 4G LTE network and as people move over there, the usage of stimulation drives them into higher tiers from a tier perspective on the Share plan.

Then of course the second piece is as they get on the Share plan they start to connect all these additional devices and you can see that with the continued momentum of our Internet category and some other things that will be coming to market similar to what we did in the fourth quarter last year as for the camera.

So combination of all these, Phil, I am very confident that we will continue on the margin track we set out at the beginning of the year.

Phil Cusick - *JPMorgan - Analyst*

Great. Thanks, Fran.

Operator

Jason Armstrong, Goldman Sachs.

Jason Armstrong - *Goldman Sachs - Analyst*

Great, thanks. Good morning. Fran, there's been obviously some buzz around Verizon investing in Canada. Maybe you can help us in terms of where you see the opportunity. Is this tied into a roaming footprint? Is it tied to maybe serving your own enterprise customer base or is there sort of a consumer retail presence you might have in mind tied to this?

And the second question on FiOS, very good volumes in what's generally a seasonally weak quarter. You talked about the 600,000 plus but it sounds like you have the opportunity to maybe be meaningfully above that result. I'm just wondering does this -- what you've seen in 2Q give you the opportunity to maybe set the bar higher for the year? Thanks.

Fran Shammo - *Verizon - EVP and CFO*

Thanks, Jason. On Canada again, let me emphasize this is really an exploratory exercise for us. As you all know, they have delayed their spectrum auction until January, so again we continue to just look at this market.

I think it's everything that you said, Jason, that we are kind of looking at. If you look at the population of Canada, about 70% of that population is between Toronto and Quebec. That's adjacent to the Verizon Wireless properties. Again if you look at the spectrum auction, it mirrors up exactly what we launched here in the United States on the 700 megahertz contiguous footprint.

So we're looking at all these but obviously some of the cautions here are the regulatory environment, a foreign investor coming into the Canadian market and what does that mean? So again, cautiously looking at it, not ready to make any announcements today and we continue to explore and have discussions, but at this point it's just really just an exploratory exercise.

On the FiOS volumes, again we put a lot of effort around continuing the superiority of the FiOS product. Bobby and his team have done a great job in around the FiOS Quantum offers and a lot of the stimulated growth that we see here is coming from the Quantum offers that we have and upgrading those Quantum offers to the 50 and 75 megabits per second services.



So look, we set a target for 600,000. Obviously if we can exceed that target we will. We are ahead of that target but I will tell you that the third quarter again is always a seasonally challenging quarter for us from a move perspective, so let's continue on the track that we are and if we can over deliver we will, but we set the target at 600,000.

Jason Armstrong - *Goldman Sachs - Analyst*

Okay. Thanks, Fran.

Operator

John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Thanks, good morning, guys. First, a quick question on Wireline and Wireless. First on Wireline, Fran in your prepared remarks you mentioned a couple of issues driving Wireline profitability that you see some improvement. I just wanted to see if you can give a little clarification. Are you talking at the year-over-year trends for the whole year or just the second half? If you could just sort of fill in those blanks for us, that would be great.

Secondly on the Wireless CapEx increase, could you just talk a little bit about what's driving that? Is it more 4G devices or is it more usage per device or is it maybe the competitive environment, what you are seeing from other carriers? But what's really driving the change there? Thanks.

Fran Shammo - *Verizon - EVP and CFO*

Sure. Thanks, John. In Wireline profitability, look, we set the bar that said our margin would be flat year-over-year. Going into obviously in the third and fourth quarter of last year, compared to what we think we can do this year and coming out of the second quarter, I think in the back half I have to improve the profitability in order to continue to make that guidance that we set out at the beginning of the year that said we would be flat on a margin basis. So I think we are on course to do that and mathematically the profit has to get better in the back half of the year in order to sustain that guidance.

As far as the CapEx on Wireless goes, there's a couple of things here that are driving us. So if you look at over the last three quarters, the growth that we've had, the number of 4G devices we've moved, and if you look at just the first half of this year versus the first half of last year, we have added 6.2 million more 4G devices on the 4G network than we had a year ago from just an overall sale perspective.

So when you look at that and you look at the usage, currently 59% of the data traffic is now running on the 4G network and that is being driven by 33% of the base. So again from just a growth perspective on the top line, we have always said again that as customers move into Shared and they realize the viability and speeds and the consistency of this 4G network, it's going to drive them to use higher usage. If you look at where video is going in the future, obviously that's going to continue the proliferation of the usage on this network.

We look out two years ahead of where we think our curve is going to be and given the past success we have had and the usage patterns and the amount of 4G devices that we've already moved and the roadmap that we see coming, we need to accelerate really the capacity that we previously thought and it's really all to drive what customers want.

So the incremental investment will more than pay for itself on topline growth from what I see and again this is really a shift in our capital discipline between Wireline and Wireless. We are going to maintain our lead on the most reliable, consistent 4G LTE network. So that's what's driving the increase for the CapEx.



John Hodulik - UBS - Analyst

Thanks, Fran.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - Morgan Stanley - Analyst

Thanks very much. Good morning, Fran. Other Wireless service revenues were very strong, up about 20% year-over-year. I imagine you've got some MVNO and maybe roaming and other stuff. Perhaps you could just comment on the drivers of that and the sustainability of that.

Then on the enterprise side, you talked about continued cautious behavior and the cost focus. Do you see any signs of a second-half pickup? I think there's some better news on unemployment and generally macro trends improving in the second half. Are you seeing any of that or is it pretty much static from your point of view?

Fran Shammo - Verizon - EVP and CFO

Thanks, Simon. On the other Wireless revenue, obviously what's included in that other Wireless revenue is our reseller base. I don't like to refer to them as MVNOs. That's a bad word for me but on the reseller base, it's really driven from the prepaid providers that we have on that side of the business. And again coming out of this quarter, we did a fairly substantial number of net adds there. And again, our prepaid strategy is between what we sell on the retail side under our own brand and we had a positive quarter again this quarter with 97,000 net adds.

But we also drive if you want to the lower end markets through resellers and mainly through the relationship with Walmart and through TracFone. So that drives a lot of volume and that has been good revenue growth for us.

The other things I would tell you, though, is that in addition to that, obviously roaming is in there. Machine-to-machine, which we don't really talk about much, we are gaining a lot of momentum around machine-to-machine and that is driving incremental revenue albeit very low individual unit per subscriber type revenues. But again as we start to gain momentum and sell hundreds and hundreds of thousands of these types of devices, that's going to contribute to those revenues and contribute to the overall growth of Wireless. So that's the component of that.

On the enterprise side, look, I understand the unemployment is there, but it is not large enough and steady enough to give me confidence that something is going to turn here in the near future. And again if you look at the enterprise space, mainly what everybody is focused on is cutting their costs and obviously when we talk about cutting costs in enterprise, they come to us and figure out how they can reduce their spend with Verizon and have us give them solutions that help them reduce their spend. Of course we are happy to do that but it does cause some topline pressure.

Also I think that again the uncertainty of what's going on around the government sector in twofold. Number one, a lot of this pressure in enterprise this quarter if you look the decline of 4.8%, over 60% of that was in the government sector for us this quarter. So there is a big impact from the sequestering activity and the pullback from both state and local governments and also within the federal government.

As I look forward, though, the uncertainty around this tax situation and if you think about it, we are now mid through the year, it's highly unlikely that we will get tax reform this year. So again we are faced with another cliff at the end of this year if Congress does not extend the tax provisions that are currently on the books for another year. So hopefully they will do that soon and put some of the uncertainty at rest at least until the next 18 months until we can get to all the difficult issues around tax reform, which as you know, we have a lot of subgroups working in Washington to help and give suggestions on how to get this done. But that's going to take some time.



So again it's hard for companies to say we are going to invest in new technologies and new things when we are not certain what the future of the tax laws hold for the books and records.

So I still don't think anything is going to change drastically from where we are and as I said before, at least from where I sit, the best we can hope for is a flat performance. If you take CPE out of the equation this quarter, we are at a 0.8% decline. So that's probably about where we will be, zero to slightly decline or slightly positive is kind of where I am at at this point in time.

Simon Flannery - *Morgan Stanley - Analyst*

Very helpful, thanks.

Operator

Michael Rollins, Citi Investment Research.

Michael Rollins - *Citigroup - Analyst*

Thanks, good morning. Fran, if you could give us the update on the net debt calculation for Verizon Wireless. And then with respect to the business, I think the metrics that you threw out there on the LTE network implies about 1.8 more usage on the LTE network versus the 3G network. I was wondering if you could expand on that a little bit more and maybe give us a sense of what the usage trends are for your customers and as they move into the Shared Data Plan, maybe give us a sense of that kind of stimulus that you are seeing on the consumption front. Thanks.

Fran Shammo - *Verizon - EVP and CFO*

Sure. Thanks, Mike. On the update of the net debt for Wireless, gross debt is at \$10.1 billion and net debt is \$9.7 billion. And as you know, we did a distribution at the end of June of a total of \$7 billion out of the partnership to both of the owners.

Also just to keep in focus here, we have about \$1.5 billion of Wireless debt coming due in the fourth quarter this year and another approximately \$3.5 billion coming due in the first quarter of next year and we plan to pay that debt off at this point in time.

On the LTE network, Mike, you are right on. And obviously what is happening is as people come from the 3G network over to the 4G network, you can see that incremental usage, whether it's a smartphone or a jet pack or a dongle and as they start to share all this data, and the video consumption is increasing year-over-year and quarter-over-quarter.

So again as we -- others in the industry have put out their projections of usage over the 4G data. If you look at some of the things that people have printed and the escalation that the future holds from a data consumption standpoint as we start to move into more symmetry between in the home and out of the home content. We don't see that slowing.

So again, yes, we do see an incredible jump when someone moves from 3G to 4G in the usage that they have on their smartphones and other devices. So that's what's driving the growth.

Michael Rollins - *Citigroup - Analyst*

Thanks very much.



Operator

Mike McCormack, Nomura.

Mike McCormack - *Nomura Securities - Analyst*

Thanks. Fran, maybe just a comment on Wireless margin. I know you've got the sort of 49% to 50% expectation for the full year. Last year the fourth quarter had very high volumes to sort of really drag down margins a bit. Are you getting comfort that the new upgrade policy should have a muting impact on that?

Then just secondly on FiOS competition, maybe just some comments regarding the triple play pricing environment out there and also how well you're doing in the MDU market. Thanks.

Fran Shammo - *Verizon - EVP and CFO*

Thanks, Mike. So on the Wireless margins, obviously again we are very confident around the 49% to 50%. As far as the fourth quarter of last year, you have to keep in mind it was the first quarter that there was a free iPhone on the Verizon Wireless Network. We won't have that repeated this fourth quarter. That's not to say that we don't see increasing volume. And again, I continue to say that we will see incremental net adds through the third and into the fourth quarter.

But from a margin perspective if you look at just year-over-year and the amount of volume we have moved, we actually ate through all that volume and improved the profitability of this business. That goes into managing the entire business.

So from an upgrade policy standpoint, some other things that we will be launching -- you probably saw Verizon Edge and some other options that we will have on payment plans for our customers to acquire a smartphone. All of these things considered, we are very, very positive on the margin progress and the profitability progress of Verizon Wireless and the continued growth of Verizon Wireless.

Mike McCormack - *Nomura Securities - Analyst*

Just on the Edge comment, is that something that you are hearing your customers actually demanding in the sort of equipment financing option?

Fran Shammo - *Verizon - EVP and CFO*

Yes, so if you look back here at time, first we were the first carrier to launch LTE technology. We were the first ones to launch the shared pricing around LTE technology. We launched in the fourth quarter of last year an installment pay plan on tablets. That's was something our customers were asking for. We delivered that to them and at that point in time, we started to look at and I said we were looking at other options for smartphones.

We've done a lot of focus groups in the last six months. We've done a lot of market research and we've come that says yes our customers are asking for another option, twofold. Number one, we have a lot of customers in the technology Edge that want to be able to upgrade sooner than they would under our historical legacy subsidy model, if you will. And we have other customers who quite honestly don't want to pay upfront for the large cost of the phone. They'd rather pay over time.

So I'm not going to get into all the details of Verizon Edge but I will let Wireless do that, but that's something that our customers have been asking for and I think we have a differentiated plan to launch to the market. And Verizon Wireless will have more to say on that.

Going back to your other question on triple play and MDU, obviously we continue to gain momentum here. Look, this business has always been competitive around the triple play, but I think what is differentiating us right now is the superiority of our product with fiber into the home and as



you get that fiber into the home, I think what customers are realizing and we see this with the copper to fiber migration, when they move and they see the speed that they can get on just their Internet capacity, we are seeing customers upgrade.

What I have said is we are seeing our legacy copper customers who we have migrated over to the FiOS network, they are paying between \$10 and \$15 more in ARPU a month after about 60 days on our network because they are upgrading freely into that 30 and 50 megabits per second service.

So that is really what is differentiating us in the market. We will continue to advertise around that superiority and I think that momentum will carry us into the third and the fourth quarter.

Mike McCormack - Nomura Securities - Analyst

Great, just a quick follow-up on the FiOS side. Is there a point at which you are going to migrate to an all IP video network?

Fran Shammo - Verizon - EVP and CFO

Obviously we've already started that with the copper to fiber migration, but that's going to be quite some time in order to deactivate the copper switches and take all that plant and equipment out. We have the plans to do that but that's not something that going to be done within this year or next year.

Mike McCormack - Nomura Securities - Analyst

Great, thanks a lot, Fran.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - Wells Fargo Securities - Analyst

Thank you for taking the question. Most of my questions have been answered but I did want to ask about prepaid, Fran. With AT&T doing the I/O and now with Leap's purchase and Cricket in the fold and T-Mobile and Sprint obviously having their own brands, is there any interest on your part in launching an independent prepaid brand under the Verizon -- separate from Verizon?

Fran Shammo - Verizon - EVP and CFO

Thanks, Jennifer. Look, I think from a prepay perspective we are very happy with how we approach this market between our own prepaid product, which obviously you've heard me talk about in the past, which is just strictly on our 3G network. We do not offer prepaid on the 4G LTE network. As I said, we will become more aggressive over time in the prepaid market on that 3G network. Because again as we look at the 3G versus the 4G and we move 3G customers into our 4G network, we want to make sure that we keep that 3G network as full as possible. Because when you think from an investment return, we're not investing any more in that network and the fuller we can keep that network without detracting the service, the contribution margin of that network is very, very high.

So prepaid is really the pillar of how we will continue to utilize that 3G network. So you will see us become more aggressive around that when we need to be. You saw us change some pricing in the last two quarters around prepaid and that has stimulated some growth for us.



As I said previously, our other path is through our resellers for the lower end market. I don't see the need at this point to do a secondary brand around the Verizon Wireless Network. We have built our brand around the quality, the reliability, a superior network. I don't think that a secondary brand helps our overall brand at that point.

The other thing I will say is I'm not going to comment on anything around the AT&T deal with Leap but I will put to bed the rumors out there that Verizon Wireless may be interested in that asset. And we are not interested in that asset.

Jennifer Fritzsche - Wells Fargo Securities - Analyst

Thanks, Fran.

Operator

Brett Feldman, Deutsche Bank.

Brett Feldman - Deutsche Bank - Analyst

Thanks for taking the question. I am not going to ask you about Leap but that deal is spectrum-driven and you guys have indicated that you are starting to deploy your AWS 1 spectrum. Maybe that's happening a little sooner than we thought although you are seeing network traffic ramp very quickly.

I'm just curious if you can maybe give us a status update on your spectrum portfolio. Do you still feel like you have sufficient spectrum to get to the next auction? Do you still see an opportunity to buy spectrum in the market right now from other carriers? Have you started to think about maybe some supplemental solutions, for example, maybe revisiting Wi-Fi as another way to put capacity into your network?

Fran Shammo - Verizon - EVP and CFO

Thanks, Brett. Around spectrum, we did our AWS deal last year and that put us in a very good spot for our 4G LTE strategy. We started to launch AWS last year. We started to pre-position that. We are accelerating the positioning of the AWS based on my comments before around the usage around Wireless. But again, we are very comfortable with our spectrum holdings and we are in good shape for three to four years. Obviously we will participate in the auction with the FCC here targeted for 2014 around the broadcast licenses. That is something that we will participate in, but we are not under any spectrum pressure.

If you look at our frequencies and the way we deployed our CDMA spectrum, we can actually take very small slivers out of that CDMA spectrum and reallocate that to our 4G LTE spectrum on a needed basis. That's where we get into this balancing act between the 3G network and the 4G network. But we are very satisfied with our holdings for the next three to four years.

Obviously we are always opportunistic in spectrum acquisition and we do actually buy spectrum every quarter. You probably don't see it because we do little markets here and there. But look, we are always opportunistic, but at this point we are satisfied and there's nothing out there at this point other than the auction that we are concentrating on.

Brett Feldman - Deutsche Bank - Analyst

On Wi-Fi, anything new there maybe involving your cable partners?

Fran Shammo - Verizon - EVP and CFO

Well, from a Wi-Fi perspective, obviously we always like people to offload when they are in their home in a secured Wi-Fi network. You've heard me talk before about Wi-Fi networks are not secure in the public domain. They have a purpose for us in certain instances around major sporting events and so forth, but our customers are very concerned about their privacy and security. That is why they ride the LTE network as much as they do.

But we do want offload in certain circumstances and so that does relieve some of the spectrum. We obviously -- from just a utilization standpoint for people that are in their homes, it's not good if they are inefficient to run off of the LTE network. They should shift over to their Wi-Fi network in their house. So we do encourage that but again not major massive public Wi-Fi is interesting for our customers at least in this point in time from a security standpoint.

Brett Feldman - Deutsche Bank - Analyst

Great, thanks for taking the question.

Operator

David Barden, Bank of America Merrill Lynch.

David Barden - BofA Merrill Lynch - Analyst

Thanks for taking the questions. Just a couple, if I could. Just following up a little bit on that, Fran, I was wondering if you could kind of give us a status update on the activities and development that's going on inside that joint innovation entity with the Comcast group and what progress if any is being made on some of the digital content rights stuff?

I guess second would be kind of along those lines, could you kind of elaborate a little bit on your relationship with NFL and kind of some of the strategy behind that content relationship and if that's the beginning of a series of potential new moves to acquire content?

If I could, just one quick last one. I noticed strategic services sales in enterprise were a little over 6% growth year-over-year last quarter that kind of slowed down into the 4% zip code this quarter. I know overall enterprise has been fairly soft but strategic services has been sort of a core strength. If you could kind of address that slowdown it would be helpful. Thanks.

Fran Shammo - Verizon - EVP and CFO

Around our joint venture with the cable companies, obviously our converged solutions team has been working and defining consumers as to what they want both in the home and outside the home. Obviously what we are learning is the 4G LTE network plays a very critical role in that. We continue to work with them. We have expanded into 968,000 Verizon Wireless stores across the US and we have about 2500 indirect locations. The marketing material and we continue to showcase these types of products.

But I will say that as we continue to work through this, it's hard for Verizon Wireless to sell a cable product outside of the FiOS footprint because it's new and it's hard for the cable companies to sell a Wireless product outside the footprint because of distribution channels.

So as we continue to work through this, we are gaining some momentum here. But I think the one last point from all of this is we are obviously very focused on the content rights and you come into the NFL agreement.

The NFL agreement we think is just a new way of how content rights can be delivered into the Wireless segment. Obviously our strategy is around both type of multicasting a live sporting event and you saw our comments that the 2014 Super Bowl will be a multicast type event to our Wireless



customers. So that's really the breakdown of the wall between what can be delivered in the home and out of home. Obviously we now have the rights to take some of the NFL live games out of the home and deliver them on the mobile devices.

So from a content standpoint, this has to develop obviously over time. The other point here around content is we are starting to see where we are getting increase from content providers that they may want to pay for their content rather than having the consumer pay. Those models are still being worked, but we will see where that goes. But I look at that as the old 1-800 number where the actual vendor pays for the usage and not the customer. So we will see how that strategy develops over the course of time.

As far as our strategic services go, we continue to have good momentum in our strat services as we refine exactly what we are doing. We have very good momentum in the Terremark and the Hughes platforms and around our cloud services. The slowdown quite honestly has been around our PIP exercise and that's more of -- it is growing but it's more a price compression within this industry, so we are facing some of that going forward. And we knew we were going to face some price compression around PIP and we have to accelerate on the other strategic services to outpace that. So other than that, we have good momentum on strat services.

David Barden - *BofA Merrill Lynch - Analyst*

Fran, just to clarify, PIP is --?

Fran Shammo - *Verizon - EVP and CFO*

IP-based solutions.

Operator

Tom Seitz, Jefferies.

Tom Seitz - *Jefferies & Co. - Analyst*

Thanks for taking the question. Can you just give us an update on your expectations for VoLTE?

Fran Shammo - *Verizon - EVP and CFO*

Sure, we are still on course for VoLTE. We will start testing and have our first handset in the market at the end of this year. Then we will probably commercial launch sometime next year. But again, as I have said in the past, the critical piece for us is that we have to make sure that our 4G LTE coverage footprint from a VoLTE standpoint equates to our 3G footprint, because the VoLTE call is not backwards compatible with the CDMA network. So when you establish a call on VoLTE within our network, if you move outside of the LTE network, you will have a hard drop on that call. Obviously that's not something that our customers would expect from a premium provider like Verizon Wireless.

So we are taking our time here. We will thoroughly test this but we are on track to commercially launch sometime in the first half of next year. Then taking that out as I've said, at the end of next year, we are on track to have our first only LTE handset to be able to provide to the marketplace as well. So we are still on track with our VoLTE strategy but it is a critical one for us to make sure that we get right when we launch.

Tom Seitz - *Jefferies & Co. - Analyst*

So the implication though then is that the 4G network is going to be essentially everywhere that the 3G network is by sometime in first half of next year?

Fran Shammo - Verizon - EVP and CFO

The 4G network is everywhere, as I said in my opening remarks, 99% of the coverage of our 4G network is equivalent to our 3G network. But now we have to go back and fill in that capacity to make sure that from a voice call perspective it will hand off because voice is different than the data piece. So we just have to make sure that a customer who is on 3G today when they go to VoLTE, they would see no difference in their service from 3G to 4G.

Tom Seitz - Jefferies & Co. - Analyst

Okay, great. If I could, could I just follow up on Dave's question? There were press reports that ESPN was considering subsidizing mobile video consumption and you sort of alluded to that as well. How soon do you think we will see a material third-party payer model? Is it this year? Is it next? Is it a couple years out? Can you just sort of frame the timeframe of what you are thinking about?

Fran Shammo - Verizon - EVP and CFO

Yes, I think the big barrier right now is how does the content provider get the value of how many people watch their content on a mobile device to be able to go back to their advertisers in order to monetize that content. Right now, that's where the barrier is and we are working on that. But until that gets solved, I think this model will be slow to come at this point in time. Now slow to come, I'm thinking maybe next year, but it is certainly not any time in this year that that model will break through.

Because they have to recognize the benefit back to their advertisers to be able to monetize that content into our network. But it is something that's being discussed. They realize that the linear model will not work as it does in TV. In the Wireless market, you can't assume that someone is going to pay \$8 a sub on 100 million subs, so that model does not work. So we are looking at other models. But the barrier is how do you measure everything to get back to the advertisers for the perceived value on that content?

Tom Seitz - Jefferies & Co. - Analyst

Thanks very much for that color.

Operator

Amir Rozwadowski, Barclays.

Amir Rozwadowski - Barclays Capital - Analyst

Thank you very much and good morning folks. On the capital expenditure front, on the back of this capital expenditure rise for the year, I wanted to ask how we should think about the capital intensity of the business going forward. It does seem as though your competitors are healthily ramping their efforts to try and improve service quality. Do you feel as though you will need to continue to put your foot on the gas in order to maintain the quality of your network here, Fran?

Fran Shammo - Verizon - EVP and CFO

Let's put this in perspective. We have moved our consensus by \$200 million to \$400 million, so this is not a huge step up in our capital spend. We just wanted to make sure everybody realized that we were going to accelerate some of the 4G LTE.



But as we have said in the past and if you look at our results through the first half of this year, we continue to really be disciplined around the capital investment across our businesses but also within the Wireline segment. So you see that come down year-over-year. We expect that trend to continue so that will offset some of the pressure we may see on the Wireless side. So I don't anticipate that there's going to be any major accelerations, but again it's too soon to tell where we are going to come out in 2013.

I will talk more about that in the coming quarters, but right now the focus is on this year and it's between \$200 million and \$400 million increment.

Amir Rozwadowski - *Barclays Capital - Analyst*

Thank you. Then if I may, we've clearly seen a pickup in terms of your Shared Data Plans. I think you mentioned that it's more than 36% of your subscribers are on these plans. I was thinking from a strategic perspective as we've seen increased promotional activities by some of your competitors to try and wean subscribers onto their networks, do you feel as though this is a potential mode in terms of protecting your subscriber base from some of these more aggressive pricing plans that are available in the market? Should we expect to see more promotional activity to try and ratchet this sort of percent of subscribers on Shared Data Plans up in the coming quarters?

Fran Shammo - *Verizon - EVP and CFO*

Look, this industry has always been an extremely competitive industry and obviously some of the promotions around unlimited have been there for the last year when we launched Shared pricing and we continue to take market share. We continue to grow our revenue very strongly.

Look, we will -- Verizon Wireless will do one thing very well. They will compete very well in the market, but we are a balanced company. We will compete, grow revenue, grow profitability, and grow our subscribers. At the end of the day, customers make choice not really just based on price but the quality of the network and that is what we've built our brand on.

So quality of the network, consistency of the network, the reliability of the network, the value that we provide to our customers through these Shared plans, and again, will we do promos here and there? Of course. As I said before, we will launch the Verizon Edge, which will give our customers yet another choice of how do they want to enter onto the best network there. So I think the key here is give our customers choice and continue with what we built our company on, which is the strongest network.

Amir Rozwadowski - *Barclays Capital - Analyst*

Thank you very much for incremental color.

Michael Stefanski - *Verizon - SVP of IR*

Brad, we have time for one more question.

Operator

Tim Horan, Oppenheimer.

Tim Horan - *Oppenheimer & Company - Analyst*

Thanks, just two questions on Wireless. Fran, you talked about the fact that your LTE network is enabling you to attract the higher quality customers, which has clearly been the case for a long time with your network. But do you have any evidence of that on maybe credit scores? Are you finding



with what you've done with LTE and the Shared Data Plans that you are you think attracting higher credit quality scores, maybe losing lower credit quality score customers?

Secondly on the Shared Data Plans, can you maybe talk about what you are seeing in terms of customers needing to increase their data buckets or are many customers bumping up against headroom or do you expect to see an acceleration of that in the next year? Or is it more like two to three years out? Thanks.

Fran Shammo - Verizon - EVP and CFO

On the high-quality, obviously we give a lot of our customers choice of various price plans and how to enter into our superior network here. Of course, credit scores have always been a component of that and I won't really get into how we differentiate the credit scores, but obviously you can see that from the growth that we have and the revenue growth that we have, this is not a major issue for us. We watch this very closely, but we are gaining customers across all aspects of the business. Let's just put it that way.

Shared Data Plan as far as acceleration of data usage, again what we see and if you have experienced this yourselves, we can continually communicate with our customers throughout the month as to when they get to their usage. And then when they get up into that 90%, we give them the ability to upgrade through their phone to the next tier. We see some very good results from that. Customers are upgrading when they need to.

So again based on our trajectory of data usage, especially with where we see video going, we continue to see the uptake in the Shared plan will continue. The usage will continue to accelerate and our revenue growth will be reflective of that.

Tim Horan - Oppenheimer & Company - Analyst

Thank you.

Michael Stefanski - Verizon - SVP of IR

That's all the time we have for questions but before we end the call, I would like to turn the call back to Fran for some closing comments.

Fran Shammo - Verizon - EVP and CFO

Thanks, Mike. I just want to leave just a couple few points of emphasis here. So our strategic investments and operational execution drove strong financial performance in the first half of this year. While we are pleased with the overall performance, we obviously know we have more work to do.

We are committed to driving shareholder value by continuing to execute our strategy and improve on the fundamentals of the business. We are focused on delivering superior customer service and providing the best portfolio of products along with the most reliable and consistent performing network. Our focus is to capture incremental revenue growth in our key strategic areas while we also transform our service delivery and cost structure.

As always, we will continue to be very disciplined around our capital investments, investing in those platforms for the innovation and the growth of the future. Through this strategy and execution model, we expect to drive incremental cash flow and earnings growth both in the second half of this year and into the future.

Thank you again for joining us and everybody, have a great day.



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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