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# EDITED TRANSCRIPT

VZ - Verizon at Goldman Sachs Communacopia Conference

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## CORPORATE PARTICIPANTS

**Lowell McAdam** *Verizon Communications - Chairman, CEO*

## CONFERENCE CALL PARTICIPANTS

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

## PRESENTATION

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**Jason Armstrong - Goldman Sachs - Analyst**

We will go ahead and get started with the next session here. We have had a real action-packed morning, with AT&T's CEO, Disney's CEO and now Lowell McAdam, the CEO of Verizon. Lowell, welcome to the conference.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Thank you, Jason. Good morning, everyone.

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**Jason Armstrong - Goldman Sachs - Analyst**

Lot going on obviously, and it is been a busy month for the industry, but specifically for Verizon. A lot of activity. Maybe if we can start with obviously the recent news, and that is taking in the residual ownership position in wireless.

You have made obviously some really good progress in funding for the wireless, \$49 billion debt deal, it was two times oversubscribed, it traded well since. Take us through the next steps here in moving this forward.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Okay. So obviously, this is a long journey. Let me just put it in context here. It has probably been about a 10-year discussion with Vodafone. And you had to have a good -- a willing buyer and a willing seller. We were always a willing buyer and I think things came together for Vodafone sort of retooling their business.

The financial structure of the deal was very important to us. Fran and I spent a lot of time with the rating agencies to understand what sort of impact the financing would be on us, and we only wanted to take a one-notch downgrade. So when you looked at that, that really dictated the structure of the deal between the debt and the equity.

When we went out in the markets, we were a little bit concerned, because obviously there were a lot of uncertainties out there. Every time Chairman Bernanke says something, the markets move, and Syria obviously makes the market move, and whether we are going to be funding the government or not makes the market move. So the timing was very good for us.

And I happened to be in London meeting with investors on the deal as we were pricing this. And we were hoping to get into the 30 kind of range for debt. We had the bridge in place, wanted to take the bridge out as soon as we could. And as the demand built, we were pleasantly surprised and made the decision there. And I know it concerned some of the investors in Europe, but we were able to take it all out in one swoop and do it all in US dollars, which made things very attractive for us.

So we are very pleased. I think that shows that the investors were bullish on the Company in general.

As we go forward, there is a lot of gates to pass through here, but we think the biggest one is behind us. We have shareholder approvals for both Vodafone and Verizon, but everything I pick up, there shouldn't be any issues there. There is FCC approval here, but we already own the asset, we already control the asset. It is a case where we are taking out a foreign owner versus a foreign owner coming in. So we don't expect any issues there.



Vodafone has a few regulatory issues. The Italy shares have to change hands, but it is not contingent on that. So we expect by first quarter we should be in pretty good shape and be able to move forward with the business.

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**Jason Armstrong - Goldman Sachs - Analyst**

Great. You know, one of the things that has been topical recently -- and we had AT&T this morning talking about seeing potential in Europe. And I think a lot of people have sort of centered in on maybe the Vodafone stub might make sense.

You had sort of the most recent opportunity to look at Vodafone holistically, the wireless stake, plus their stub European assets; yet you opted for just the wireless stake. So you I think have taken a different view on Europe and the opportunity than one of your key peers has in the US. Maybe take us through that decision.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, you know, Vittorio and I have worked together for 20 years. And I was on the Board of Italy when we hired him to be the Chief Operating Officer and was involved in the startups in Portugal and Spain and Germany, and so I know those markets well. I think they are terrific markets.

But you have to take a look at priorities, and we are always very disciplined about these things. And as Vittorio and I looked at a potential merger, we could make a pretty good story about enterprise. There was an okay story about synergies. But if you looked at the next five years, the growth prospects for us in the US so outweighed the prospects for Europe, mostly because of the economy and partially because of the regulatory environment, I could not make a strong case for the Verizon shareholder that it was better to merge than it was to go more aggressively in the United States. So that is the approach we took.

Now, I think the way we have structured this is it gives Vittorio the chance to retool his business. And you can see he's already doing it. And I know Andy Halford will be here tomorrow. I have tremendous respect for Vittorio and Andy and Steve Pusey, the folks that were on our Board. They will figure out how to use these proceeds to make their business stronger. We will be able to make our business stronger, so it is a real win-win and that is the approach we decided to take.

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**Jason Armstrong - Goldman Sachs - Analyst**

Great. I think when you announced the deal, you talked more specifically about One Verizon, some of the other initiatives that maybe could benefit under full ownership of Verizon Wireless. How quickly would you expect these type of benefits to materialize?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, the first minute of the first hour of the first day. I mean, if you look at the structure we put together -- and I know many of you have challenged our assumption -- I am happy to be conservative in this area -- but 10% EPS on day one is a nice added benefit for our shareholders.

But from there, I want to be clear, Vodafone never stopped us from doing what we need to do. But I think this will make us more agile. And the future that I see ahead for Verizon and Verizon Wireless is one of converged services. And I will bet between Bob and Randall this morning you had some discussion around that.

But when I look at our cloud assets, our security assets, our telematics assets, our FiOS assets and our mobile assets together, I think that the services that we're going to be seeing 12 and 24 months from now will utilize all of those.

And we had a bit of a false wall here between the organizations that was very difficult to work through it. We did, but it took time. And I think what we will see here going forward is a lot more agility to meet customer demands in those areas and, frankly, to innovate ahead of the market.

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**Jason Armstrong - Goldman Sachs - Analyst**

This is obviously a big bet on US wireless, effectively doubling down and a really big price tag obviously attached to it. So if you look at --.



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**Lowell McAdam - Verizon Communications - Chairman, CEO**

It was a good value.

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**Jason Armstrong - Goldman Sachs - Analyst**

A good value, but a big number.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Exactly, right. Thank you.

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**Jason Armstrong - Goldman Sachs - Analyst**

So it is interesting -- we have got corporates sort of going in one direction, you guys doubling down, Softbank pouring a ton of capital into US markets, and corporates seeing a very interesting opportunity. Yet I've got to tell you, when I talk to investors, they are sort of increasingly concerned about what this amount of capital coming into this industry actually means for competitive activity.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes. Well, there is a little bit of illogic here, I have to say. Because when you see Softbank pouring capital into Sprint and Deutsche Telekom merging and improving their networks, that is all great, it shows great faith in the US market and, so we buy ourselves, and it is like, oh, the market is in trouble.

So I don't see that at all, it doesn't make any sense to me. The people that are running these businesses are good businessmen. And when you are going to put a lot of money into a network, you are going to look for a return on capital. And so unlimited in a video environment, where you don't get to monetize that investment, I don't see that.

Price wars, when you have the cash flows, if you look across the industry, the cash flows that are being generated and the investments that are being put in place, I don't see us going the way of Europe. I don't think the regulatory environment will force us there. I think the FCC and the administration sees that this is one of the bright spots in the US economy, we continue to pour billions of dollars into the network, creating a lot of jobs. So I just don't see the environment allowing us to deteriorate into the position that Europe is in.

And I can ensure our investors we never have and we never will be leading on price.

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**Jason Armstrong - Goldman Sachs - Analyst**

And so historically, Verizon's hallmark has been network leadership, and that continues into today.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

You meant to say it is.

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**Jason Armstrong - Goldman Sachs - Analyst**

Is, continues. I guess the -- we've had things to the point to -- CDMA technology differentiation, leadership position in LTE. As peers catch up on LTE and it is all sort of one common standard and spectrum positions sort of look a little more equalized across the industry, what is Verizon's leadership position in technology and network going forward?



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**Lowell McAdam - Verizon Communications - Chairman, CEO**

So, we could -- we should dissect that question a little bit here, Jason. So I think the premise to that question is that 4G is it. And that is not the case at all. I mean, Hans Vestberg from Ericsson is in town tomorrow night. What are we talking about? 5G. What is 5G all about? Video. I mean, that is -- 4G has shown the potential of video, it is not optimized for video. So I mean that is the next step.

So, look, our view is we have got lots of headroom within 4G. We've got, I think, 35% roughly of our customers and almost 60% of our traffic is already 4G. So we have got opportunity to see the network improve there.

We're continuing to build, we're continuing to invest in spectrum. We've got opportunities to optimize our network. But I will tell you, I think that we have got a year on our closest competitor and we've got three or four years on the other two competitors. And we are going to continue to push that advantage.

And when you start to integrate things like our broadcast technology that we are going to demonstrate at the Super Bowl this year, right in New York, people will be excited about that. And you start integrating cloud and the other telematics solutions, there is no wall in front of us on network leadership. And we are going to exploit that.

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**Jason Armstrong - Goldman Sachs - Analyst**

And in terms of the industry structure, I mean, there has been obviously near-term investment from Sprint really sort of doubling down network efforts, DT recommitted. When you invested or announced the deal for all of Verizon Wireless, to some extent that had to be a bet on the long-term industry structure. Is there sort of a bet embedded in that, the three players longer-term?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

So, we are having fun with questions today here. So I don't -- I mean, the industry structure isn't a factor in this deal, whether it is three or it is four.

I think, Jason, that thing we try to do is figure out where customers are headed and we try to play our game. And what we do isn't predicated on somebody's price move or somebody investing another \$8 billion in the network or whatever. We try to play our game. And so whether there is three or there is four doesn't really matter.

Now personally, I think the regulators are going to want to see things play out with the four structure before they allow anything significant. I mean, there is still a lot of small players, the regional players, that could be consolidated, and that is probably good for them and good for -- probably there's only two players that they will allow to do much consolidation. But we don't need to. I mean, we have got the footprint laid out that we like and we have got the assets that we like and we are going to press that advantage. So the market structure doesn't impact that.

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**Jason Armstrong - Goldman Sachs - Analyst**

Okay. You talked about unlimited before, and that being a very challenging model. I think the margins of some of the companies that obviously offer that would probably bear that comment out. What breaks that model from a competitive perspective?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

I am not sure that competition does as much -- I am an engineer, and so to me, it is physics. When you build your network capacity up at this level and you lose a lot of customers, you've got a lot of headroom. I mean incrementally it doesn't really cost you anything.

But at some point, you hit that capacity. And with unlimited, the more service they use, I mean you've got a ceiling; you don't get any return on that invested capital. So I think that is the physics that sort of breaks it. And then there is the spectrum issue as well.



So if the future materializes, which we believe in wholeheartedly, that there's going to be more and more video and mobile becomes the center of all the communications, you have to have spectrum capacity. And if you are allowing unlimited usage, you just run out of gas. So to me, it is physics more than it is the market.

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**Jason Armstrong - Goldman Sachs - Analyst**

Great. You know, Verizon has been in an industry-leading position as it relates to not only network but revenue growth, and obviously the two are linked. How do we think about the sustainability of where you have been trending at service revenue growth rates, which has been in the 7% or 8% range?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes, so, I think we have -- we are at the lower end of smartphone penetration of our peers here. So I think we are at 63% or something; I think Randall mentioned this morning he is at 73%. So we have got room to go there. So that will continue to drive it.

Those of you that are creating your models, 8% is probably not sustainable. We expect to see a lot more growth. And I expect to see -- I expect to see growth in areas like machine-to-machine, which might be \$0.25, \$0.50 ARPU, if you think about it from that perspective. And so that will obviously have an impact on the account accretion rate. But the margins on those are 70%, 80%. So I will take those all day long.

But we expect to see some tapering off of that, but there is still some headroom. And then again as you bring in services like video that will require a fair amount of usage, I think you have got several competing interests here. So we expect that growth rate to taper off but still be substantially positive here over the next couple of years.

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**Jason Armstrong - Goldman Sachs - Analyst**

You mentioned machine-to-machine. It seems like a huge opportunity. There is a lot of different things that could play into this. But I think investors sometimes have a tough time conceptualizing what the opportunity might be because we hear about devices at \$0.25 or \$0.50. But it seems like in aggregate this is a big opportunity. But I'm wondering if you could help frame it.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

I spent a lot of time looking at this -- and Roy Chestnut is out in the audience, our Head of Strategy. If you look at health care or you look at energy or you look even at vehicle telematics, every one of those is in the tens of billions of dollars of market potential. So look at the opportunity for the pie to grow for the industry, I would like the position that we are in with our cloud and security and some of the other video assets. But I think that will help the entire industry rise and I think we are in a good position.

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**Jason Armstrong - Goldman Sachs - Analyst**

I think you and AT&T have talked about the opportunity for content actually paying for distribution to some extent, like the old 800 model. How far along are we in these discussions and when can that be a reality?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Did Bob say much about that earlier today when he was here?

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**Jason Armstrong - Goldman Sachs - Analyst**

I missed that presentation (multiple speakers).



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**Lowell McAdam - Verizon Communications - Chairman, CEO**

So how about the audience? Did Bob say anything about that? ESPN has been one of the more advanced, I would say, in those sorts of discussions. So I don't want to comment if Bob did or he didn't.

But that model is certainly there, the demand is there. I hear an awful lot about ad insertion. We developed a platform called the Verizon Digital Media Service, or VDMS, that is commercial today. And one of the uses for that is to be able to as you translate the content to go on to any device to insert the appropriate advertisement for that. And you see a lot of big data analytics to try to figure out who the customer is and then shape that. So I think that is coming next, and I do believe you will see the 800 number, if you will, for video content. But my guess is that is still a couple of years out before it is a big factor.

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**Jason Armstrong - Goldman Sachs - Analyst**

Okay. Let's talk maybe about the other side of content, and that is you paying for content, but on your wireless platform. The recent deal with the NFL, is that sort of a one-off just very differentiated content, and this is sort of a four-year trial? Or is this really a blueprint of other things we should consider with Verizon Wireless having sort of access to proprietary content for customers?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes. Well, the model is really evolving now and I think it has got everybody's attention. The discussion that we had with Roger Goodell and his team, they really want to expose the NFL in a much bigger way to people outside the normal broadcast model in stadium. And I think the technology that we have in front of us gives them the ability to do that.

And so we are going to experiment with a number of things. And I mentioned broadcasting the Super Bowl, that is a big deal. So I think about that model as sort of all sports and then all other content that expires with time, if you will. So the news sorts of broadcasts.

So this -- there is two big factors that are helping with that. The first one is this eMBMS, or the multicast, gives us the ability instead of dedicating a channel per user, we can put up one channel and tell every handset to turn to that channel. That is what will use for the Super Bowl. So that is sort of a proof of concept.

The other is that there is a lot of very interesting compression work going on. I won't say which particular Company -- you may be covering them -- but where today it takes us about 10 megabits to handle video on a per-subscriber basis, I have seen technology that will be commercial in the next six months that will take that down to 2 and more likely 1.5. So you just saw a huge capacity improvement in the network to deliver that sort of video.

So I think there will be a lot of experimentation over the next 24 months, but I would say for the first time when I meet with folks like Bob and Les Moonves and Jeff Bewkes that there is a belief that this could be incremental for the networks. Not that it won't cannibalize a part of it, but mobile can be incremental, and so people are trying to figure out so what is the model.

And I think we are in a position because we have FiOS and because we have mobile, we are not viewed as a total disruptor here. We can be a partner. And I think you are going to see some dramatic shifts in the next 12 months. Which is why, back to your first question, why are we bullish on the US? That is part of the reason.

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**Jason Armstrong - Goldman Sachs - Analyst**

And how does -- this broadcast layer that you are talking about, and Randall mentioned it today too -- how does this sync up with a usage-based pricing model? How do you drive incremental revenue from this?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, I mean, there will be things like NFL Mobile that there will be subscription fees to. There will be some that you get a series of advertisements. And then there will be some where the content provider does the 800 number.



So I don't think any of us are smart enough at this point to tell you exactly what the model is. But there is clearly enough variables here for us to play with that we will be able to come up with something that makes a win-win for the content providers, the subscriber and the carrier.

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**Jason Armstrong - Goldman Sachs - Analyst**

Great. Moving to the cost side, I just wanted to focus on the handset side. Obviously, it is such a big moving part in the wireless cost structure. You have made progress in sort elongating eligibility requirements at 20 to 24 months. I think despite that, we have seen upgrades sort of relatively flat year-over-year. A lot of this stuff may sort of be occurring at the end of the year and position us well for 2014. How do you think about handset cycles?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, the upgrade cycle, we can put policies in place that sort of put some friction in the process, and I think that is a good thing. In the meantime you do some of these of model changes like our -- the financial model changes, like Edge. I think every carrier now has sort of a lease program, if you will, so you have a contract on the handset as well as service. With the CDMA chip coming out of the phone as we go to voice over LTE, that helps.

But the biggest driver of this is the excitement of the handset. When something comes out and a customer wants it, every carrier is going to do their best to get it in their hands. And I think you saw with the iPhone 5 launch over the last couple of weeks, there's lots of interest in that.

So I think the thing that we've been able to do is give options and put a little friction for those who, oh, gee, I think I'll go out and upgrade my handset today. So that has been good for our bottom line.

But at the end of the day, I think a carrier is going to take care of a customer -- you give good handsets, they use it more, that is a virtuous cycle.

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**Jason Armstrong - Goldman Sachs - Analyst**

Is there an opportunity sort of relative to the cycle and pushing the rate per device down?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

You mean what we charge a customer or the subsidy that we get?

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**Jason Armstrong - Goldman Sachs - Analyst**

The subsidy.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes, the subsidy that we have to give really is going to depend on the variety of operating systems. So I mean, you saw a big announcement yesterday with BlackBerry. That may breathe new life into BlackBerry. With Nokia and Microsoft getting together, I think there is -- you've got some good software capabilities, you got some good hardware capabilities. I think that helps.

The thing though that I think we get -- we lose a little bit is Android, because it is not just one device that uses Android. You have got a Samsung version, an LG version, an HTC version, et cetera. There are -- there is more competition than it would be if there was just two operating systems.

So I don't think we are in a horrible place here by any means. We've certainly been vocal about encouraging a third and a fourth operating system; we will continue to do so. But it is not -- it is not a cornered market at this point either.





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**Jason Armstrong - Goldman Sachs - Analyst**

Maybe thinking more holistically about costs across wireline, wireless. You in your tenure as CEO have brought a lot of cost discipline to the business. If you think about One Verizon, a little bit more integration between wireline and wireless, where do you see the biggest opportunities in the cost side from here?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, there is so many of them, that honestly -- I mean, I do spend a lot of time. Fran certainly spends a lot of time here. We have done a number of things already. We have -- Fran created one finance organization. So we pulled all of the teams together that do all the transactions, that saved us a lot of money. We have one supply chain, one real estate organization.

We just, in the last two months, pulled one product development group together. And I think that is crucial, because we are developing video products in four or five different parts around the organization. So that is important.

But I think the bigger thing for us is that we instituted a couple of years ago a Lean Six Sigma program, which some of the companies we have learned from Xerox and Honeywell and GE, that really -- you just find pots of gold, we call it, all over the business. And we can maybe go into a couple of other examples here in the future. But taking systems out, improving the products and the processes. This year alone will be \$3.5 billion to \$4 billion of cost coming out of our infrastructure. We will do at least that much next year. And I think that kind of discipline is important for us in a business our size, as you kind of continue to reinvent yourself.

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**Jason Armstrong - Goldman Sachs - Analyst**

And so if we think about what this means at the segment level, we had a big stair step-up in margins this year, 49% to 50%. I think when you first talked about it, a lot of people had their doubts. I think you effectively have proven that wrong through the year. Does that exhaust what we can do in wireless or do you think we can move even higher from here?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

No. I mean, I -- okay, so I've got to watch your questions; you are really on your game today, Jason. So for those of you that are thinking about us making a comment about expanding margins, don't. I think for us, it is about maintaining, is how Fran and I think about it. I mean, you are running a business 48% to 50% margins. If we can continue to hang onto those, we will.

And Dan Mead, Marni Walden do a terrific job in the Wireless business, and they are very focused on taking costs out. So I think this year they are \$2.5 billion. I think Dan's target is that or more. Next year -- this year, as an example, we will just give you this example. When we started Wireless, we had a 54% call-in rate, meaning 54% of our customers called us every month. And at \$7 a call, do the math. Now you've got when 100 million subscribers, that call-in rate is down to 16%.

So it takes a real discipline of what is going on with the handset, what is going on with the bill, what is going on with the product. We use the term, customers don't call us for entertainment value. And so what are you doing to aggravate them to have to call you.

So Dan closed I think three call centers this year, and we have roughly 1000 people in each of the call centers. So if you have that sort of discipline, you can continue to take costs out of the business. And we have huge opportunity on the wireline side of the business. John Stratton, I think, killed about 2000 products this year, and we have taken 350 systems off line last year; I think we are already at 250 this year. So that sort of discipline gives you the ability to streamline your infrastructure. And when you do that, you are easier to do business with from a customer's perspective. And so again, it is a virtuous circle.

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**Jason Armstrong - Goldman Sachs - Analyst**

Maybe switching gears just to Wireline. Maybe we will start with the enterprise, which FiOS is a terrific story. Enterprise, you've put a lot of interesting assets in place to drive growth. We haven't necessarily seen the growth yet and that is more of an industry comment as well.

Are you at the point where you are confident that this is the right asset portfolio for the future and you can drive meaningful growth out of enterprise?



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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, I hope the answer is no, that it is not the right asset portfolio, to be honest. Because the enterprise customer's needs change so much that you've got to keep up with it.

Now, I would tell you I'm very comfortable with the platforms that we have in place. I think about the network in sort of three steps. The connectivity is the network. Then the platforms are the things that help drive more usage onto the network, and so that is things like Terremark and Hughes. And then you have the third step-up is the solutions that we can provide that drive -- that operate off the platforms and drive even more usage.

So I feel like the network is strong. Tony Melone is still doing a lot of work on the wireline side of this. And so we can improve and get better. We've got great platforms in Cybertrust and Hughes and Terremark. I don't see big investments there.

But where I see the investments are in areas like solutions. So doing more on security -- as the hackers sort of change their approaches, we have to change ours, and so we will be developing software there. We are very big into healthcare and energy solutions through the machine-to-machine platform. Hughes, which we bought for the telematics asset, can also do those other machine-to-machine functions. So we will invest to develop the solutions for those.

Now the overall enterprise is -- people in the audience see -- they are not spending a lot of money. And every time we think about a government shutdown or something like that, there is a little bit more hesitation in the system. But our view is that we will be positioned very well when it takes off, we can take a lot of cost out of the business and we will be ready to ride that wave when it comes.

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**Jason Armstrong - Goldman Sachs - Analyst**

And maybe -- so you mentioned government relative to enterprise, maybe medium-size business. I think what we've heard from others in the industry is actually if you disaggregate this, enterprise isn't as bad as sort of the corporate level enterprise reporting makes it look. And medium-size business, probably the same thing. And government has been incredibly weak and that is what is dragging this entire category. Is that --?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes, that is true. We are the largest supplier to the federal government. And so through sequester and all the other uncertainties, that causes a big drag on the business. So I don't know when that is going to turn around.

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**Jason Armstrong - Goldman Sachs - Analyst**

If we switch to the wireline FiOS side, I will open it up for audience questions after this. FiOS, terrific product, great consumer reception. It is priced very competitively. In general, offering, I think, in line or better capabilities than cable.

How do you think about -- I know you had longer-term penetration goals when you initially sort of surfaced this business model that it seems like in many markets you are probably past this point. Is there a way to kind of level set what the real expectation should be going forward?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, we are, I think, on average of about 39% market share on the broadband and about 34% on TV at this point. And we have been gaining about 200 basis points roughly a year. I've got some markets, Texas, where we have been there the longest, we are over 50% penetrated on broadband and right at 50% on the TV side.

Right now, the fastest growing market for us is New York. And it is not just because of the CBS deal. I mean, we have -- when I come into New York, I'm always almost accosted by folks that say, it is not in my building. What can we do to get FiOS in our building? And we are doing our best there. But I think there is good opportunity.



Now, the New York market is a great example where we already run the fiber down the avenues and it is a short stub to go into the building. And we are being well-received.

So I think there's still a lot of headroom left. I know your next question is probably are we going to get more LFAs and expand further? I don't think so at this point. We are doing some major technology shifts within FiOS to make it more efficient. We see the mobilizing of it helping to contribute to the profitability, utilizing both of those assets. And I think sort out the stubs into places that we already passed and we are decommissioning copper, all those things make the FiOS ecosystem much more profitable. We're going to concentrate there for the next couple of years.

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**Jason Armstrong - Goldman Sachs - Analyst**

In some of the earlier markets where you have pushed through 50%, what is -- I am sure obviously the product -- the growth in the penetration decelerates at some point; it has to past 50%. But is it still inching up every quarter that sort of says, we should at least set our sights on 50% and actually in some of our early market 60% or 70% seems achievable?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

I wouldn't say 60% or 70%. My goal would be to get them all up into the 45% sort of range. And the markets like Texas at 50%, where we can get there, we will get there. And they do keep inching up, by the way.

So to me, though, much more focused on being efficient about it. I mean, we have got now almost 2 million optical network terminals that were active at one point and are now interactive. So I want to go back with a better product set and activate those, and those are almost free from a capital perspective.

So I think -- and the other breakthrough technology that I am excited about -- we will be testing it in the fall here -- is a media server in the home, which eliminates all requirement for co-ax, once you get into the optical terminal in the basement or wherever in the house. That slashes the installation time, and therefore makes the product a lot more profitable for us going forward. It eliminates set-top boxes, it is all IP-based going forward.

So I think there is a cycle, a turn here that I want to do on making FiOS more profitable in the current model before we ever look at expanding further.

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**Jason Armstrong - Goldman Sachs - Analyst**

Great. We will take some audience questions now. If you have a question, just raise your hand and we will get a mic to you.

## QUESTION AND ANSWER

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**Unidentified Audience Member**

Your counterpart was bragging about his balance sheet flexibility. Given the big deal you just did, I was wondering what kind of timeframe should we think about as far as you being able to restore some flexibility to your balance sheet, given the interest and dividend requirements that the new capital is going to require.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes. So we spent a lot of time thinking about the debt structure and how quickly we could pay it back. We also, though, gave ourselves significant headroom to do things like spectrum that we wanted to do, to be able to do some of these smaller tuck-in acquisitions for software companies and those sorts of things. So I have got the flexibility to operate the business with lots of degrees of freedom going forward.

As Fran has said -- I think he is in the room somewhere -- but we are looking to regain that step-up in our rating in the next 4 to 5 years. So we will have a lot of debt to pay down, but we've got a lot of cash flow to do it with. So I feel like we've got all the flexibility we need to operate the business.



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**Jason Armstrong - Goldman Sachs - Analyst**

Other questions? Maybe I will just round the discussion out --.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

There is one more.

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**Jason Armstrong - Goldman Sachs - Analyst**

Yes, sorry, back here.

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**Unidentified Audience Member**

The architecture for multicasting over wireless is a little bit different between AT&T and you guys. It seems like AT&T is thinking of using sort of dedicated spectrum, maybe some of the media flow spectrum they bought. It sounds like you are not thinking of that. Have you thought about those architectures and why are you choosing what you are choosing?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Yes. The architecture debate is probably better left to the Melones and the Donovans of the world than the Randalls than me. I think, though, we think a lot about our spectrum harmony. And by that, I mean how does the spectrum work across a broad set of products and devices.

And I love the way our spectrum is set up -- I never frankly hoped that we would get this -- but having 700 that touches every square inch of the US. And then to do the deal with the cable company, so we had AWS that touches nearly every square inch of the US. And then having the PCS and the 800, that really fits well for us and it is part of the reason why our network performs as well as it does. The network is not constantly looking for what piece of spectrum is available where.

So our thinking is that if you can simplify the network and simplify the device and do this over 700C, in our case, you do it. But if you don't have it, you go and you find another way to do it. So my guess is it will work well with whatever spectrum they choose to put it on. But for us and our application, it made more sense to utilize that foundational spectrum.

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**Jason Armstrong - Goldman Sachs - Analyst**

We have got time for one more audience question. Otherwise, we will leave it there. Here we go.

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**Unidentified Audience Member**

Can you talk about the chief regulatory issues you are presently following and what we should be keeping an eye on ourselves, and what challenges indeed you are seeing on the regulatory front?

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Well, the regulatory issues are things that frankly keep you up at night, because you often don't see them coming until they are on you. I think the beauty of the back in the '96 Telecom Act was that it was such a light touch on broadband and mobile. And that is -- and I sit in Europe talking to investors all the time -- that is the biggest difference between the US and Europe.

I was working in Europe back in the mid-1990s, and I think Europe was ahead of the US. And they have overregulated that environment so that people aren't investing the way they should be, and you can see what has happened to them. So I hope, as Tom Wheeler comes in -- I know Tom well -- I hope that he will be able to hang onto that light regulatory touch and allow people to make these sorts of investments.

We have had to take some positions, frankly, that we didn't want to take. I mean we did not want to have to sue the government over net neutrality, but it opened the door for them to get into price regulation of broadband. And I think that is not their charter, and I think it would be a mistake for the US economy and certainly the telecommunications ecosystem.

So those are the things that sort of keep me up at night. Do I see a threat on the horizon right now? I mean, Randy Milch would probably answer that, yes. But I think I am hopeful as Tom comes in he can maintain the current sort of posture.

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**Jason Armstrong - Goldman Sachs - Analyst**

Great, well, we will leave it there. Lowell, thank you very much.

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**Lowell McAdam - Verizon Communications - Chairman, CEO**

Okay, thank you all. Thanks, Jason.

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**Thomson Reuters Editor**

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