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EDITED TRANSCRIPT

VZ - Verizon at Morgan Stanley Technology, Media & Telecom Conference

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Simon Flannery *Morgan Stanley - Analyst*

PRESENTATION

Simon Flannery - *Morgan Stanley - Analyst*

Okay. Good afternoon, everybody. My name is Simon Flannery, telecom services analyst at Morgan Stanley. My great pleasure to introduce Fran Shammo, Chief Financial Officer of Verizon. We've got a lot to talk about, so we will get right into it.

But first let me please note they are all important disclosures, including personal holdings disclosures and Morgan Stanley disclosures, appear on the Morgan Stanley website at www.morganstanley.com\research disclosures or at the registration desk.

So Fran, Verizon has had some impressive growth for the last couple of years. You have put out some encouraging guidance in general terms for 2013, but perhaps you can just talk a little bit more specifically about what you see as the main growth drivers over the next year or two?

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

Okay. Well, thanks, Simon, and good afternoon, everybody. Thanks for inviting me here.

So just from a trajectory perspective, we came out of a very strong 2012, and let's start with wireless first.

So with wireless, our strategy is all around building out our LTE network, continuing to build that out. Get the LTE footprint equal to the 3G footprint that we have by midyear this year. We launched our Share Everything plan midyear last year, which was a very different type of price plan for the industry, and that was more of a usage-based price plan. And to our surprise, 23% of our base has already converted to that price plan.

So when we look at that, that actually surpassed what we thought it was going to do. So, as I take that momentum coming out of the fourth quarter and all the growth that we had in the fourth quarter and put that into 2013, I am having very good momentum from a growth perspective. My revenue increase is on track with what we expected both from a service revenue increase and an ARPA increase on the revenue-per-account perspective. We have customers who are joining into that shared price plan moving off of the 3G network into the 4G network. That's good for us for two perspectives. One is higher usage on the 4G network, billed by up in tiers in the 4G network, and the 4G network is a less costly network to operate, at least 5 times less costly than the 3G network.

So when you look at all that and then you look at just the cost structure of Verizon Wireless and we said we've taken about $5 billion out of the cost structure over the last three years, we have another $2 billion designated for this year. So when I look at that all of Wireless, I am confident with the guidance that we gave on the fourth-quarter call that said, we'll get back to the second- and third-quarter margins of last year, which is between 49% and 50%.

And then on the other side of the equation, when we get to wireline, if we split that between consumer and enterprise, on the consumer side, again, I think we had a very successful 2012. It was the first time in 10 years that we actually saw consumer revenue increase, and that was really driven off of the FiOS platform. And now we're approaching 70% of that consumer revenue is driven off of that FiOS platform. We've really concentrated on FiOS Quantum, which is our Internet offer and the speeds and the tiers of those speeds.

So when you connect up the strategy of copper to fiber migration, moving customers into that fiber, letting them experience those speeds, they are on their own choosing to upgrade those speeds to the higher tier, which also drives the revenue ARPU of the wireline customer. So I'm confident

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that the consumer side of the house, as Lowell always likes to say, we see a lot of green shoots starting to come up. And I think we hit an inflection point last year, and I think we are on a good trajectory there.

Now on the other side of the equation, we have enterprise. And I think unlike some others there, there's a lot of -- been a lot of speeches about I think it's improving. We see some signs it's improving. I don't see those signs yet. And it could be that the segment that I am in, there is a lag here as when the economy went down I lagged about six months before we saw it. Maybe I don't see it yet, but I think with all the uncertainty in Washington, especially now around the sequestering, I just don't see -- I don't see any growth, but I don't see it getting worse. I just see it as flat this year.

So when you take all that into combination and then you take in the fact of we're targeting in our investments in Verizon Digital Media Services, the Redbox joint venture. We have some other things around Hughes going on. We continue to build out the Terremark asset that we acquired. So in that contrast, I feel good about 2013.

Simon Flannery - *Morgan Stanley - Analyst*

Great. I think one of the challenges investors face for the industry overall is that we have an industry that is maturing in terms of smartphone penetration, although you have more headroom than some others. But particularly, we have new players coming in with SoftBank's purchase of Sprint. We have T-Mobile launching LTE; Sprint rolling out LTE. So how do you feel that you can sustain the sort of momentum that we've seen, both in terms of net adds, 1.6 million, 2.1 million, and in terms of margins in the face of certainly some of the aggressive attempts that -- in terms of your net add performance and basically the whole industry because these plans are predicated on taking market share from you and AT&T?

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

Yes, so I mean first let's talk about the competitive environment. I've been in this industry, the wireless industry for 17 years, and it's been an environment that has been competitive since day one. And that hasn't changed, and I don't think that will change into the future. But I think the one sign that it does show about this industry is you have two investors outside the US who are making investments in the wireless business in the US. So it more or less says what we already knew, which is there is a lot of growth to be had in the US market. And you see that from the investments that are coming in and people want to gain access into this marketplace because we do believe that there's still a lot of growth in this wireless industry.

And so if you look at -- so from a competitive environment, I think that's good. That gives the consumer choice. That gives -- that keeps us more competitive as an industry, and that means there's more technology and innovation to come. So I think that's all good.

As far as Verizon Wireless is concerned, I mean we look at this as we've built our brand around the best network, giving our customers plenty of choice, and being the best customer service provider that we can be. And that is what our brand is built on, and we're not going to change from that strategy. So to us, it's just executing, giving the customer the choice, making sure that we remain the best, most reliable network in the world as I like to measure it, and I think the customer makes the choice based on what we deliver. And also, given that I have the lowest churn rate in the industry, that means that when I gain customers, they are happy and they stay with us.

Now, you have to give them the value; you have to be on your game every day. Competitors make us do that every day. So I think that's good, and I still think, Simon, that there's plenty of growth here. If you look at just the -- okay, we talk about the smartphone penetration and I have more runway than some others, but look at what my growth came in 2012. A lot of my growth came from Internet devices. So when we launched the shared plan, we had people connecting their tablets more; we had people buying MiFi cars where they could run three tablets off, but that's incremental growth for us. Which is why we changed our metric to an ARPA metric and away from ARPU.

In the fourth quarter, we launched our first LTE camera. So we had a camera that connected up to the LTE. You send your pictures into the cloud. That is yet another device that you connect to shared pricing.

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So, again, as we evolve and bring more and more devices to this marketplace, I still think there's plenty of growth here.

Simon Flannery - *Morgan Stanley - Analyst*

One of the really impressive stats you gave at year end was the 50% of your traffic is now on your LTE network, and I think it was not quite a quarter of your devices were on there. And people are choosing big buckets. How do we start to monetize this? Are you starting to see people trade up to larger buckets and create some overage? Is that going to be a major phenomenon this year and next year?

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

Yes, well, I think that really was the basis of the strategy, right? So when we think about where we sit, if you look at the trajectory that we say, one piece of it is you come in to shared pricing; a look at your device lineup, and what we're seeing is people are attaching devices more and more. So part of the growth is I come in and we see it.

When a new customer comes into Verizon, they are much lower in the number of devices that they attach to a shared plan. But we see over the months that they are with us, they start to attach more and more. So that's one piece of the growth, okay? Because the more you attach, the more you're going to drive usage, hence you are going to buy up in buckets.

So what we see, is if you look at the ARPA metric, which is the revenue per account, you're seeing that stepstone that we see. And I still see a future for that to happen because of the number of devices that we will attach.

Simon Flannery - *Morgan Stanley - Analyst*

And presumably an iPhone 5 on LTE is using more data than an iPhone 4 on a 3G network, as well.

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

Yes, we don't split between devices, but obviously, when you go over to the 4G network and you experience those speeds, your usage is much higher than what it was on 3G network.

Simon Flannery - *Morgan Stanley - Analyst*

And while we're on the phone system, Verizon was there really at the birth of Android. And you lead with the droid brand, and that was a very important differentiator for you for a long time. I think this quarter the iPhone was the majority of your smartphone sales, and the whole industry took a hit on the margins. How should we be thinking about this 2013/2014? Do you think we will still have two major OSes, or do you think there's an opportunity for this blackberry or for some of these Mozilla and other things coming out of the Mobile World Congress this week?

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

Well, as I said last year, I thought it was important that there would be more competition in the operating system. We launched the Windows Phone in the fourth quarter of this year. I am actually carrying that phone. It's a very good phone. And I think it's going to take a little while to get some of these other operating systems up. Blackberry is coming back with their device here at the end of March, and then they'll launch their next one in the Midsummer with the keyboard on it. So we'll have to wait and see here.

But it's very important for us to make sure that we have a lot of competition in this segment; we have more operating systems; and that's important for the carriers because the more competition we have there, then that means that competitively the devices will start to come down in price. It is

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exactly what happened to the basic phone environment. So it's good for us to get more of that competition, and that's not to say that Android and Apple are not great operating systems and their not great partners, they are, but we need more competition in that environment.

Simon Flannery - *Morgan Stanley - Analyst*

And then the subsidy comes down in mode. Do you have any sense if the upgrade cycle, it can lengthen as well?

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

Well, the upgrade cycle, as I've said, for this 2013, I look at it as will be flat with our upgrade percentage as we were last year. If you recall, back in the 2011 timeframe, the carriers made a lot of changes to upgrade policies. I mean we at Verizon, we made a lot of policy changes. We went away from new every two. We instilled the $30 upgrade fee. We've done some things in 2012 behind the scenes to manage upgrades a little bit more tight with the frontline. So there's still a lot of things that we think we can do to manage the upgrade cycles without causing any customer dissatisfaction, which then helps the bottom line of Verizon Wireless.

So from an upgrade standpoint, I don't think it changes in 2013.

Simon Flannery - *Morgan Stanley - Analyst*

One of the major achievements of Verizon Wireless in the past year has been enhancing your Spectrum position. You closed the SpectrumCo transaction. You divested some 700 megahertz. Where are you in terms of Spectrum, in terms of your needs over the next few years, and are we done now with divestitures or swaps?

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

I think just a couple of things on this. So, first off, on my Spectrum needs, I think we're in an extremely good position for the next four to five years. And the reason we are that is because we have the 700 megahertz contiguous, which we launched LTE on. I am now filling in the AWS Spectrum with the SpectrumCo deal and some other swaps, the most recent agreement that we've entered into with AT&T by selling the B will get some AWS back. So we're filling that AWS for the capacity.

And then what makes me slightly different than maybe some others is the way we deployed Spectrum in our 3G network was in very -- and I'm not an engineer, so pardon the language here, but in slivers. And we will be able to take those slivers and move them as we need that capacity and free up capacity in 3G. So we have a good road here for about four to five years.

Now having said that, I mean obviously we are very attuned to what the FCC is doing from a Spectrum auction perspective. And, of course, Spectrum is not an unlimited resource. So when it becomes available, you have to grab what you can grab in order to protect the future of your business, which I think we've shown we've done very well in.

But going back to have the swaps stopped or not, I think it is showing that we need a strong secondary market for Spectrum swaps. And we need this ability to be able to get the Spectrum and the people that can use that Spectrum and exchange Spectrum or sell Spectrum. And I think that's a healthy ecosystem that we need to maintain within the industry.

Simon Flannery - *Morgan Stanley - Analyst*

Great. And then on your relationship with Vodafone, there's been a lot of discussion in the media about some of the European opportunities, and how do you think about -- you mentioned for years that you would like to buy that stake, but there's different ways there's different -- do you buy

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it in stages? If you do it just by book, Verizon Wireless stake that they have, or do something different? Any constraints here? Put on leverage? Use equity?

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

It's a great question, and I was watching the clock because I had an under-over bet here that it would take 15 minutes to get to this one. (Laughter)

Look, this is a saga that has been going for 12 years, and I'd like to say, talk is cheap. And I think we've been very open that says we would love to own the other 45% of our investment. We are a willing buyer. We have a way to do this. But look, they know where we are if they want to sell. And that's really all there is to say.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. And how does that tie in with the Italian stake? Any -- is that something that you have -- are wedded to or --?

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

Look, we own 23%. It's been a great partnership with us there. We get some intelligence into the European market and the challenges that they have. It's been a great business. Unfortunately, it's come under a lot of pressure in the last two years. It's just a minority stake that we have, and if there is an opportunity to monetize that, I will. And if there's not, I won't.

Simon Flannery - *Morgan Stanley - Analyst*

So I talked about the SpectrumCo deal a second ago. Can you give us some more color about how the joint venture of the marketing arrangements are going with the cable companies? What are the proof points that you're looking for that we feel like you are really getting some traction with those offers and more to come in terms of products, rollouts?

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

Sure. So, obviously, the first stake here was to get the cross-selling up to speed, and we continue to do that by launching new markets with the cable partner in those markets. And that's pretty much a concentration right now is getting that frontline to be able to cross-sell those products between the cable company and Verizon Wireless.

And then behind the scenes, obviously, we have this innovation joint venture that we talk about. And there's a product roadmap. The teams are talking, and because it's -- first, you have to get the platform right because that platform has to talk to all the different systems between the different parties. So you have the cable companies; you have Verizon; you have FiOS; you have all the different parties here that this platform has to be able to communicate with. So the first effort is to get a consistent platform, and then we can develop technologies on top of that platform. So at this point, that's the stage we are at, and I'm sure that we'll have more to announce later in these years.

Simon Flannery - *Morgan Stanley - Analyst*

Okay, good. If we turn then to wireline in more detail, I think one of the challenges for the entire industry is margins. We've seen some of the cable companies struggle with content costs. You have some of that pressure. You also, like many of the wireline brethren, are losing some of the higher margin as subsidy revenues and so forth. How much do you focus on getting the wireline margin turned around versus focused on the consolidated margin, and what are the pushes, the gives and takes in 2013 around wireline margin?

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

Yes. Well, I would tell you there's a lot of effort right now, both from Lowell and I, really concentrating in on the wireline margin. We know that that is important for us to improve on. It's absolutely something that's critical from a cash flow perspective s the cash flow of the wireline unit has to improve.

Now, of course, there's a lot of headwinds there, too, obviously from the enterprise side. But if you look at -- again, if you go back to consumer, I think the trend we're on is the right trend. I'm confident that the consumer margin will improve in 2013, and they will contribute more. But there's a lot of offsetting things to that.

We had a great union negotiation in 2012 that will generate, we've said, $250 million of benefit in 2013, up to $500 million toward the tail end of that agreement. So that is the first stages of how we improve this. The work rules alone with call sharing in our call centers is something that we really couldn't quantify, but we know that that's going to generate some business for the wireline unit.

Lowell's big concentration is around the Lean Six Sigma effort and really looking at processes from beginning to end and really re-generating and re-tooling and re-doing these processes to make ourselves more efficient.

So we're actually taking this opportunity in our enterprise space during this, what I will call a lull period of time, to make sure -- and we know that at some point, this is going to start to turn. And the critical piece for us is, this business was always a resource-intensive business. So you signed a major contract. You hire heads to source that contract.

What we're trying to do is really improve our systems over the last year and into this 2013 so that when a trend does turn, we're not going to have to add as many people to handle the uplift. The systems themselves will be efficient enough to generate more bottom-line impact.

So it is absolutely a focus of ours, Simon. And I said on the fourth-quarter call, given all the pushes and pulls for next year, I don't see margin improving in wireline. I think the business will improve, and it will set us up for a much better 2014.

But given where the enterprise piece is and our international assets are, I think there's too much headwind for this year.

Simon Flannery - *Morgan Stanley - Analyst*

One of the impressive points of differentiation for Verizon is the capital intensity has been coming down the last couple of years. You're obviously ahead of some of your peers in LTE buildout. So can you go through your budget for this year and just talk about what your priorities are on the investment side, both on wireless and wireline?

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

Well, I said the CapEx would be flat with last year. We will continue to improve our CapEx to revenue ratio. But really, I mean the strategic efforts right now are obviously Verizon Wireless with LTE. We are not investing any more coverage or capacity in 3G. We are only investing to keep that network up and running, and that's critical. Because if you think about where we were in 2012, we really were still building two networks through midyear. So we've taken that capital allocation and moved it all to 4G.

Simon Flannery - *Morgan Stanley - Analyst*

But you'll still need 3G for voice for a while?

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

Yes. We still have a large percentage of our base still on the 3G network, 70% or so.

But the point here is is I don't need to spend more coverage and capacity in that network. That capital has been reallocated to the 4G. So 4G LTE is absolutely a strategic investment.

The Hughes Telematics acquisition was a strategic acquisition for future investment. Terremark in datacenter and cloud is something that we're looking to continue to invest in. Machine to machine is another one. The Redbox joint venture, to get that off the ground. Verizon Digital Media Services is another facet of where we're investing for really the wireline business, and all those things I just mentioned out of LTE were all in the wireline side of the business.

So we're making these other investments in wireline that really, if you think about it, the whole corporation, including wireless, needs a cloud solution. The whole corporation needs a machine to machine platform to be successful in machine to machine.

So we're investing outside to create value outside of the Verizon Wireless portfolio for the other piece of our portfolio, which is a strategic initiative of ours. And then, of course, on the copper-to-fiber migration, that is, again, another strategic initiative we're making to improve the wireline margin by reducing the cost of maintaining that copper plant. So that's really the strategic investments that we are focused in on for 2013 and going forward.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. And one last question before I open it up to the audience, I think with the improving capital intensity, the strong profitability, you're starting to throw off a lot of cash flow, but your leverage coming down. Can you talk about how you think about buybacks? It seems like the timing may have moved up a little bit. There is a greater arbitrage between your cost of funding and your dividend yield, particularly your free cash yield, versus other uses of that cash.

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

Yes, well, I think that obviously we did generate a lot of cash in 2012. We paid debt down with that cash. We did a pension annuitization with that cash. We went out and spent $4 billion for additional spectrum. So we are investing for the future and, in essence, de-risking our balance sheet. We increased our dividend for the sixth consecutive year. The dividend policy we know is important to our investors. It is important to Lowell and I. It's important to our Board. So a consistent policy is critical for us.

The actual leverage and deleveraging perspective -- I always get this question because people say, well, aren't you satisfied with your leverage?

Well, it's really how the credit agencies look at us, and a lot of them take in the pension liability and the unfunded OPEB as well. So we have to look at that to make sure that our credit rating is strong, which it is.

Share buyback I said we wouldn't do until the end of 2013. At the fourth-quarter call, I said we'd be in an opportunistic position to start buying back shares if we felt that that was something we needed to do. So it's not like I'm going to run out and borrow money to buy back shares. But we have enough cash flow that if the opportunity presents itself, we will buy back shares. So all of this is important for return on investment.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Okay. With that, let's open it up to the audience.

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QUESTIONS AND ANSWERS

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

It's a quiet crowd today.

Simon Flannery - *Morgan Stanley - Analyst*

We have one up in the front here. Just wait for the mic.

Unidentified Audience Member

Can you expand a little bit on the comment about multiple operating systems and the benefits you derive from reduction subsidies as you move more from a duopoly to more of a --?

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

I missed the first part of your question, I'm sorry.

Simon Flannery - *Morgan Stanley - Analyst*

Multiple operating systems.

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

Multiple operating systems in wireless?

Unidentified Audience Member

Smartphones.

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

In smartphones. Well, again, I think that from just an overall ecosystem, if you will, in the competitive environment, the one question that we always get is around subsidies of our smartphones. And the one way that we reduce subsidies to get more competition in the operating systems, and that's really what I'm looking at.

But if I go out even further than that, if we can get some strong competition within the operating systems and you think about where the future is going between VoLTE, which is voice over LTE, and at some point that will come at the end of 2013 into 2014. And if you start taking that ecosystem out, pretty soon you will not embed a CDMA chip into your handset. That automatically reduces the subsidy of the handset.

So I've been asked this question and I continue to believe that over the next two to three years and you will start to see the subsidy of handsets be reduced by a number of factors coming into the environment.

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Simon Flannery - *Morgan Stanley - Analyst*

So Google Fiber has been getting a lot of media attention of gigabit to the home. FiOS is no slouch, as a consumer of it myself. But how do you think about the speed wars and what you need to deliver and where you are today in terms of continuing to be at the cutting-edge?

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

Yes, look, I think what we pay attention to is the competitors in our space. So we watched that, and the cable industry and the entertainment industry is very, very competitive. I think FiOS brings a very different perspective to the household with fiber to the home. But we actually tested a 1 gig circuit in New York three years ago. So our FiOS product can deliver that. We just don't see the need yet from a household to have that much of a pipe into their home.

Now what we've built on over this last year is FiOS Quantum where we're giving our customers the ability to buy up to the speed they want. We now offer 300 megabits per second.

So we give that ability to buy that much speed if you wanted. And like I said before, Simon, what we're seeing is as copper to fiber migrates, customers are, in fact, buying up to that speed. And it looks like the speed that most customers are buying up to are the 50 megabits. That seems to be the sweet spot in the business right now.

Now, as households get more connected devices in them and we start to really view where video viewing is going to go in the future and so forth, does the household need more pipe in the future? Probably. But with our FiOS products, it's not a lot of additional investment because I've already put the fiber to the print.

Simon Flannery - *Morgan Stanley - Analyst*

So you're able to keep bringing that ARPU up on the --?

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

Correct. That's our view.

Simon Flannery - *Morgan Stanley - Analyst*

A question here?

Unidentified Audience Member

(Inaudible question - microphone inaccessible).

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

So the question was, as folks continue to build out their LTE networks, will the price from a consumption standpoint follow where voice was?

Look, I'm not sure -- I can't predict what happens in this industry. It's such a dynamic changing industry. But I think that what we set out in midyear of last year with our shared pricing more or less set up the ecosystem to tell customers that you can consume as much as you want, and you can share as many devices as you want. So we went away from $30 for each device gets you only so much in that capacity or unlimited, if you will. But

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the unlimited model was not a sustainable model when you got to an LTE network because of the consumption that we saw that could happen on that network.

So from our perspective, we're now giving unlimited voice and text because that's where the industry went. And now we are at a statement of based on you can bring 10 devices and based on your usage, you'll buy into the tier that you want to buy.

Now some people will manage that between WiFi and networks. Others will not, and we see both sides of that.

As far as what others will do in pricing and so forth, I can't answer that right now. And look, this has been a very competitive industry. It will continue to be competitive. And I think we've met competition before. And again, as I've said, the brand is really around the best network, the best value to our customer for that network and the best customer service in the industry, which we just won again in J.D. Power's.

Simon Flannery - *Morgan Stanley - Analyst*

Maybe we will just finish with the last clarification and share everything -- do you have any early indications of what the churn looks like? If I have 10 devices in 10 different -- and multiple uses, presumably that's a very sticky product. I know it's early, but are you starting to see data that supports that?

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

Well, look, I think that -- you can make that connection back to family share plans as well. I mean the more and more of your family you get into your network, the stickier it is. I think that goes to speak to our leading churn metric from the industry perspective. So I don't think that is going to change that.

Simon Flannery - *Morgan Stanley - Analyst*

Great. Well, Fran, that's all we have time for. Thank you very much for your time.

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

Thank you, everyone. Have a great day.

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