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VZ - Q4 2015 Verizon Communications Inc Earnings Call

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OVERVIEW:

Co. reported 4Q15 operating revenues of $34.3b and GAAP EPS of $1.32. Expects 2016 adjusted earnings to plateau at a level comparable to 2015 adjusted earnings.

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PRESENTATION

Operator

Good morning and welcome to the Verizon fourth-quarter 2015 earnings conference call. (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 Communications, Inc. - SVP, IR*

Thanks, Carlos. Good morning and welcome to our fourth-quarter 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.

As a reminder, our earnings release, financial and operating information, the investor quarterly, and the presentation slides are available on the investor relations website. A replay and a transcript of this call will also be made available on our website.

Before we get started I would like to draw your attention to our Safe Harbor statement on slide 2. 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 the Verizon's filings with the SEC, which are 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 included in the financial materials we have posted on our website. The quarterly growth rates disclosed in our presentation slides and during our formal remarks are on a year-over-year basis unless otherwise noted as sequential.

Before Fran goes through our results I would like to highlight a few items. For the fourth quarter of 2015 we reported earnings of $1.32 per share on a GAAP basis. These reported results include a few nonoperational items that I would like to highlight.

Our year-end mark-to-market adjustment of pension and OPEB liabilities included a pretax $3.2 billion credit, which decreased our pension and OPEB liability. This adjustment, which was primarily non-cash, was caused by an increase in the discount rate, the adoption of new mortality assumption tables, and the execution of a new prescription drug contract during 2015. We also incurred pretax expenses of $613 million, primarily related to severance costs under our existing separation plans.

On an after-tax basis, these two items amounted to a net $1.6 billion or $0.40 per share. Additionally, we recognized a pretax gain of $254 million on a spectrum license transaction. On an after-tax basis, this gain amounted to $158 million or $0.04 per share.

Excluding the effect of these nonoperational items, adjusted earnings per share was $0.89 in the fourth quarter compared with $0.71 a year ago, or a growth of 25.4%. For the full-year adjusted earnings per share was $3.99 compared with $3.35 in 2014, an increase of 19.1%.

On a non-GAAP illustrative basis, if we assumed 100% Wireless ownership for all of 2014, the adjusted earnings-per-share growth rate was 16.7% year over year.

As a reminder, included in our Wireline results are the operations from the three states that we agreed to sell to Frontier, which we expect to close at the end of the first quarter of 2016. We recognized a benefit of $0.13 per share for the full year due to these assets being classified as held for sale. Additionally, the operations of AOL have been included in our consolidated results since third quarter of 2015. Prior period results do not include AOL.

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

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

Thanks, Mike. Good morning, everyone, and Happy New Year.

Entering 2016, we are confident in our three-tier strategy of leading at the network connectivity level in the markets we serve, developing new business models through global platforms in video and Internet of Things, and creating certain opportunities and applications and content for incremental monetization. Our execution model enables us to compete effectively in every market condition and build our capabilities for future growth and profitability as an innovator in the digital-first mobile world in 2016 and beyond.

As we reflect back on 2015, we demonstrated a balanced performance in a dynamic competitive environment. We delivered quality growth and strong financial performance in our operating segments, while improving our strategic position and returning value to our shareholders. Overall, our full-year adjusted earnings per share grew 19.1% and free cash flow increased to $18.8 billion excluding tower proceeds, which enabled us to invest and return value to our shareholders.

Fundamental execution on our strategies is the priority within our segments. In Wireless, we posted another quarter of quality connections growth and profitability, with sequential improvements in postpaid gross and net adds as well as net phone additions. Postpaid net adds totaled 1.5 million for the quarter and 4.5 million for the year, excluding wholesale and Internet of Things connections.

Net phone additions were 449,000 for the quarter and 1.1 million for the year. Customer retention was also a highlight, with postpaid churn of 0.96%, down 18 basis points for the quarter. For the year, churn was also 0.96%, which improved 8 basis points from prior year. Total Wireless revenue grew 4.6% for the year and our EBITDA margin expanded.

Our Wireline quarterly results were highlighted by Fios revenue and customer growth. Additional enterprise and wholesale revenues slightly improved sequentially while we reduced costs. Overall, our full-year Wireline segment EBITDA margin of 23.5% was up 30 basis points.

We remain committed to consistently investing in our networks for the future. Our 2015 investments have positioned us for growth and allow us to maintain our network leadership position, as consistently acknowledged by third parties.

Wireless densification enables us to add capacity to manage the growing trends of video consumption and the demand required for the Internet of Things, as well as prepositioning us for the future 5G technology. We invested in AWS-3 spectrum during the year, acquiring spectrum covering 480 markets for a total value of $10.4 billion.

We continued to execute a disciplined capital allocation model with the priority to invest for the future. We are committed to returning value to shareholders and maintaining a strong balance sheet.

During 2015, we announced the divestiture of certain Wireline properties to Frontier and intend to use the proceeds to pay down debt. We monetized the majority of our remaining cell towers and we were able to return value to shareholders in the form of an accelerated share repurchase of $5 billion. We have returned more than $13.5 billion to shareholders during the year including dividends.

As we disclosed in September, our Board of Directors approved a 2.7% dividend increase, which raises our annualized dividend to $2.26 per share. This was the ninth consecutive year that our Board approved a dividend increase, affirming their confidence in the strength of our future cash flows. We remain committed to returning to our pre-Vodafone transaction credit-rating profile in the 2018 to 2019 timeframe.

So, overall, a strong, balanced 2015 which provides operating momentum and lays the foundation for the future. Now let's get into fourth-quarter and full-year performance in more detail, starting with our consolidated results on slide 5.

Total operating revenue in the fourth quarter was $34.3 billion, an increase of 3.2%, including revenues from AOL. We are pleased with AOL's performance in the fourth quarter, which does have some seasonality from advertisers.

For the full year, we added $4.5 billion to our top line, representing growth of 3.6%. Excluding AOL, which was not part of Verizon a year ago, our top-line growth was 0.5% for the fourth quarter. Excluding both AOL and prior-period revenues from the public sector business we sold in 2014, the comparable full-year revenue growth rate was 2.6%. This was below our revenue guidance due to lower wireless phone activations, primarily upgrades, and a less-than-projected take rate on our device installment payment program in the fourth quarter.

Historically, our consolidated revenues have been primarily driven by growth in both customers and consumption in wireless and Fios. The change in the Wireless commercial model from an equipment subsidy model to a device installment payment model increases the revenue sensitivity to Wireless equipment volumes. We continue to manage through the transition to the device installment model.

We remain committed to our Verizon Lean Six Sigma processes on improving the customer experience while increasing our overall operating and capital efficiencies. The focus on increasing efficiencies has enabled us to sustain a strong earnings profile as we manage through the revenue transformation in the Wireless and Wireline segments.

Consolidated adjusted EBITDA totaled $46.6 billion in 2015, an increase of 7.7%, and our adjusted EBITDA margin for the full year was 35.4%, which expanded 130 basis points from 2014. Let's turn now to cash flows and the balance sheet on slide 6.

In 2015, cash flows from operations totaled $38.9 billion. This total included just under $2.4 billion of proceeds related to the tower monetization transaction, which is nonrecurring. Free cash flow for the year, excluding the tower proceeds, totaled $18.8 billion.

We have been successful in selling selected device installment receivables in the private securitization market to finance the device payment program and manage working capital. In the fourth quarter we continued to sell device installment receivables and received about $2.7 billion in cash proceeds. For the full year 2015, we sold a total of $9.4 billion of device installment receivables, resulting in total net cash proceeds of $5.9 billion at year-end.

We expect to continue to sell these receivables in 2016. Given the success of the device payment program, high credit quality of our customer base, and retention history, we are exploring further diversification of funding sources.

Our capital spending was consistent with our guidance of around $17.5 billion to $18 billion for the year. In total, capital expenditures were $5.2 billion in the fourth quarter and $17.8 billion for the full year, up 3.4% from 2014.

Our balance sheet is strong and enables the financial flexibility to grow the business. We ended the year with $110.2 billion of gross debt, net debt of $105.7 billion, and a ratio of net debt to adjusted EBITDA of 2.3 times.

Now let's move into a review of the segments starting with Wireless on slide 7.

In the Wireless business, revenue growth, profitability, and cash flows are driven by our high-quality retail postpaid customer base. Total Wireless operating revenues grew 1.2% in the quarter to $23.7 billion. For the full year, operating revenues totaled $91.7 billion, representing growth of 4.6%.

Service revenue of $17.2 billion declined 5.6% for the quarter and declined 3.1% for the full year. Equipment revenue increased to $5.4 billion, up 28% for the fourth quarter, and grew 54.4% for the full year. Service revenue plus installment billings increased 1.4% in the fourth quarter and 2% for the full year.

We expect that service revenue growth will continue to be pressured as more of the customer base moves to unsubsidized service pricing and that equipment revenues will grow as the activation rate for device payment plans increases. The percentage of phone activations on installment plans increased to 67% in the fourth quarter, compared with about 58% in the third quarter and about 25% in the fourth quarter of last year.

The fourth-quarter take rate accelerated but was below our expectation of 70%, which contributed to equipment revenue growth that was lower than expected. We expect the first-quarter take rate for device installment to be above 70%.

During the quarter 7.6 million phones were activated on device installment payment plans. We have about 25 million device installment phone connections in total, representing approximately 29% of our postpaid phone base. Overall, more than 40% of our postpaid phone customers are on an unsubsidized service pricing.

In terms of profitability, we generated $9.1 billion of EBITDA in the quarter, an increase of 18.9%, and approximately $39 billion for the full year, an increase of 10.6%. Our EBITDA service margin increased to 52.9%, up from 42% for the fourth quarter. The more meaningful measurement is EBITDA as a percentage of total Wireless revenue, which expanded to 38.4%, up from 32.6% in the prior year. For the full year the EBITDA service margin increased to 55.3%, up from 48.5%, and our EBITDA margin on total Wireless revenue was 42.5%, up from 40.2% in 2014.

Now let's turn to slide 8 and take a closer look at Wireless connections growth.

We ended the year with 112.1 million total retail connections, excluding wholesale or Internet of Things connections. Our industry-leading postpaid connections base grew 4.4% to 106.5 million and our prepaid connections totaled 5.6 million. Postpaid gross additions improved sequentially to 4.6 million for the fourth quarter and to 16.4 million for the full year.

Our disciplined focus on customer retention resulted in improved postpaid churn of 0.96% in the quarter compared with 1.14% a year ago, an improvement of 18 basis points. We are very focused on improving the customer experience starting with the network, simplified pricing, and better execution in our distribution channels. We are seeing lower customer service call-in rates, which is an indication of improved customer satisfaction.

Our retail postpaid net additions of 1.5 million were high quality, with a sequential improvement in the number of 4G smartphone and total phone net adds. We added 906,000 new 4G smartphones in the quarter, which were partially offset by a net decline in 3G smartphones, resulting in 713,000 net new smartphones.

Total postpaid phone net adds totaled 449,000, which included a net decline of basic phones. Tablet net adds totaled 960,000. Net prepaid devices declined by 157,000. Full-year net adds of 4.5 million included 3.3 million 4G smartphones and 3.5 million 4G tablets. The offset to these additions were net declines in basic phones, 3G smartphones, and non-tablet Internet devices.

Let's now take a look at 4G device activations and upgrades on slide 9.

Total postpaid device activations totaled 13.4 million in the quarter and 46.6 million for the full year. Similar to prior quarters, about 84% of these activations were phones, with tablets accounting for the majority of the other device activations. We ended the year with 73 million smartphones in total and our smartphone penetration increased to 84% of total phones. 4G devices now comprise more than 79% of our retail postpaid connections base.

Growth in 4G device adoption is driving increased data and video usage. Approximately 90% of our total data traffic is on the LTE network and overall traffic on LTE has increased by approximately 60% over the prior year. About 8.4% of our retail postpaid base upgraded to a new device in the fourth quarter, which is up sequentially but down from just under 10% in the fourth quarter of 2014.

Wireless capital spending totaled $3.3 billion in the quarter and $11.7 billion for the full year, up 11.5% from a year ago. We continue to invest in our 4G LTE network to provide the industry's highest reliability and position ourselves to capture the efficiencies and capabilities of new technologies. We are expanding capacity through a number of optimization techniques, effectively managing our spectrum and further successfully densifying urban markets.

National studies recognize Verizon as the overall 4G LTE network performance leader, leading in categories of overall performance, network reliability, network speed, data performance, and call performance. These are the performance metrics that matter to the customer.

Improving the cost structure of our Wireless segment is a priority. In the fourth quarter, we restructured our wireless organization to improve our ability to address the changing needs of our customers faster and more efficiently. We will continue work on our operating model on an ongoing basis and are confident that we can improve efficiencies, as we have done in the past.

Let's move next to our Wireline segment, starting with a review of our consumer and mass markets revenue performance on slide 10.

In the consumer business, Fios remains the driver of revenue growth and now represents 80.4% of consumer revenue. In the fourth quarter consumer revenue grew 2.6% and for the full year grew 3.5%. Mass markets' revenue grew 1.5% in the fourth quarter and 2.4% for the full year. Small business, which is included in mass markets, experienced declines of 5.6% in the quarter and 4.6% for the full year.

The change in the consumer revenue growth trajectory continues as customers right-size their existing bundles and core voice services decline. The demand for Fios broadband only is also increasing, while we are continuing to see a decline in linear video demand. Customers value having a choice in selecting linear video packages.

We had another quarter with Custom TV representing about one-third of our Fios video sales. In the fourth quarter, Fios total revenue grew 6.8%, with consumer Fios revenue growing at 6.6%. This growth was driven primarily by broadband subscriber growth and increased penetration of Quantum.

The increasing importance of the Internet is evident as customers are requesting higher data speeds. At the end of the quarter, more than 70% of our consumer Fios Internet customers subscribed to data speeds of 50 megabits per second or higher and we have shifted our introductory offers to 50 megabits. We are also seeing an increasing number of customers opting for higher speeds.

As I highlighted earlier, Fios Internet subscriber growth remained strong in the fourth quarter. In broadband, we added 99,000 net Fios customers for the quarter and 418,000 for the year and now have a total of 7 million Fios Internet subscribers, representing 41.8% penetration. Overall, net broadband subscribers increased by 5,000 in the quarter.

In linear video we are seeing slowing of market demand. We added 20,000 net customers in the quarter and 178,000 for the year and now have a total of 5.8 million Fios video subscribers, which represents 35.3% penetration. We are working closely with Frontier on the sale of our Wireline properties in Florida, Texas, and California and expect to close the transaction at the end of the first quarter of 2016.

Let's turn to slide 11 and cover enterprise and wholesale, as well as the Wireline segment in total.

In the enterprise space, secular and economic challenges remain, but we are seeing stabilization on a constant currency basis. In the fourth quarter, global enterprise revenue declined 3.3% and on a constant currency basis was down about 2.1%. For the full year, global enterprise revenue declined 5.2% and on a constant currency basis was down about 3.5%.

In our global wholesale business, revenues declined 0.2% in the fourth quarter and 3.4% for the full year. While this quarter improved due to seasonal impacts, we remain cautious on the wholesale business and believe that a 4% to 5% decline is more indicative of the underlying trend for the full year 2016.

Total operating revenues for the entire Wireline segment improved to a decline of 0.9% in the quarter and down 1.8% for the full year. The segment EBITDA margin was 24.2% for the quarter and 23.5% for the year, up 30 basis points for the quarter and the year.

As we have consistently stated, we are very focused on margins and improving the profitability of the Wireline segment. We are committed to reducing our cost structure while maintaining strong customer satisfaction. We have achieved savings from restructuring our network and service provisioning and are seeing improvements in productivity.

We continue to reengineer our work processes to improve efficiency and reduce costs, with some of the future savings depending on timing and the outcome of our current labor negotiations. As we close on the Frontier sale, we are confident that we will offset the stranded cost at a consolidated level and will report more details post transaction.

Capital spending in Wireline was $1.6 billion in the fourth quarter and totaled $5 billion for the year, down 12.2%, which is consistent with our strategy to reduce our capital spending in the Wireline segment. Let's move next to slide 12 for an overview of our three-tier strategy.

During 2015 we delivered strong results and further demonstrated our ability to compete effectively in a dynamic competitive environment as we worked through the transition of our Wireless base from a subsidized equipment model to a device installment payment model and ramped up new business models to generate incremental revenue growth into the future. Total revenue grew at 2.6% on a comparable basis and we delivered adjusted EBITDA margin of 35.4% for the year.

For 2015, adjusted earnings per share of $3.99 continued to grow at double-digit rates, even if you exclude the depreciation and amortization benefits we realized from the Frontier transaction. Cash flows from operations increased about 19.1% for the year, excluding tower proceeds, and free cash flow totaled $18.8 billion. We delivered more than $13.5 billion of value to our shareholders in the form of an accelerated share repurchase and dividends.

As I discussed in my opening, entering 2016 we are confident in our three-tier strategy. We are executing and delivering strong results today throughout our operating model by growing and serving our customers, while driving cost and capital efficiencies.

We are focused on building on our network strength and laying the foundation for global platforms and applications and content that appeal to all market demographics, especially the Millennials. We refreshed our brand image around the Better Matters campaign to increase awareness of our differentiated strategy around the overall customer experience and to appeal to growing markets.

At the network connectivity layer, we are investing in our 4G LTE network to provide the industry's highest reliability and position ourselves to capture the efficiencies and capabilities of its new features. We are expanding capacity through a number of optimization techniques, effectively managing our spectrum and further successfully densifying urban markets.

We opportunistically purchased spectrum during the year to enhance our capacity and position us for the future. As we have done throughout our history, we evaluate spectrum opportunities in a disciplined manner, including the upcoming auction, secondary markets, and future spectrum bands that can be made available.

Leadership in 5G technology is another strategy to extend our premier network position. We are working with key partners to ensure the aggressive pace of innovation, standards development, and appropriate requirements for next generation of this wireless technology. We will begin pilots in several locations throughout the year.

Our networks enable us to grow our business through new ecosystems in video and the Internet of Things at the connectivity, platform, and solution layers. We are targeting the Millennial opportunity in Wireless video beyond connectivity. The acquisition of AOL and Millennial Media during the year added strong capabilities with global ad tech platforms and content to complement our digital formatting and content distribution assets.

AOL is scaling its consumer and advertiser base globally and it is positioned very well to take advantage of the strong secular growth trends in mobile and video as we saw in the fourth quarter. We will look to further enhance our media asset capabilities. AOL's global capabilities and partnerships are instrumental to our overall long-term global digital media strategy, which includes premium content, distribution, and advertising platforms across all screens.

We believe there is a significant opportunity in using the programmatic platform with the data from the Wireless customer base to connect consumers and advertisers in a very targeted and scaled way with relevant and engaging ad experiences, while protecting individual privacy. The go90 application that we launched in 2015 is one element of this broader video strategy that will allow us to capture and aggregate audience, deliver mobile-first content, and generate incremental revenue via advertising. As the application, which uses our video platform, evolves and gains attention, you can expect new and exciting content, features, and functionality like the NBA content we added this past quarter.

We are encouraged by the use of go90, not only on the Verizon network, but off of the Verizon network as well. During 2016 we expect to share more results around both the go90 application and our video platform.

Earlier this week we launched FreeBee Data, a new sponsored data service. With FreeBee Data, Verizon Wireless subscribers can enjoy content on their mobile devices free of data charges and it helps businesses drive engagement and revenue by providing a powerful platform for sponsoring mobile content.

As we have been discussing over the past two quarters, we are offering Custom TV for linear customers to provide more video choice. We will continue to look to refresh our Fios TV offerings to take advantage of the secular trend of video bundles with options and more choices to address the increasing over-the-top video trend.

We are taking a leadership position in the Internet of Things. With our experience in networks, devices, platforms, and applications, we have created an ecosystem that will foster innovation and scale globally above the connectivity layer to enable incremental growth. Our network leadership positions us to capitalize on these new opportunities that require both a ubiquitous mobile experience and the capabilities of platforms above the connectivity layer.

We are focused on the telematics and transportation vertical and launched our direct-to-consumer product, hum, in the third quarter. We also announced our connected city strategy beginning with Savannah and introduced a suite of developer tools, ThingSpace, to accelerate innovative applications to come to market.

At the recent Consumer Electronics Show, the pipeline for mobile Internet of Things capabilities was very prominent. New revenue streams from the Internet of Things are growing, with revenues of approximately $200 million in the quarter and about $690 million for the full year, a year-over-year increase of 18%.

Let's move next to slide 13 for our 2016 priorities.

Our strategy and priorities remain consistent for 2016. We will concentrate on growing our quality customer base in both Wireless and Fios and build upon customer loyalty by providing the best overall customer experience. We remain focused on network leadership and developing new ecosystems in video and the Internet of Things by leveraging our ubiquitous network in the United States and scaling our platforms globally.

We are also committed to returning value to our shareholders and maintaining a strong balance sheet in addition to returning to our pre-Vodafone transaction credit-rating profile by the 2018-2019 timeframe. As previously stated, Verizon expects full-year 2016 adjusted earnings to plateau at a level comparable to our strong full-year 2015 adjusted earnings, due to device installment payment model transition, completion of the Frontier transaction, and the ramping of new business models in video and Internet of Things.

Additionally, we are targeting the following for 2016: a consolidated adjusted EBITDA margin consistent with our full-year 2015 performance; consolidated capital spending between $17.2 billion and $17.7 billion, this includes capital spending of approximately $150 million for the properties sold to Frontier; and a minimum pension funding requirement of approximately $550 million. In terms of income taxes, we expect our effective tax rate for financial reporting purposes to be in the range of 35% to 36%.

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

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

Fran, thank you. We also recognize that there might have been some delay in posting our materials to our website. The issue I think is resolved, so we appreciate your patience.

Carlos, if you can open us up now for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) David Barden, Bank of America Merrill Lynch.

David Barden - *BofA Merrill Lynch - Analyst*

Thanks. Thanks for taking the questions. Fran, just as a housekeeping item, with respect to the notion of a quote-unquote plateau, could you kind of band that for people? Are you trying to put a plus or minus 1% or 2% around the $3.99? Are you trying to say $3.99 or better for 2016? Just so the street can get a sense as to where the real midpoint there is?

Then, second, obviously we had an extension in bonus tax depreciation last year. It has been something you have been benefiting from. Could you kind of scope the size of the benefit you're going to get this year?

If I could, just one last one. You've talked about how cord-shaving has been important for the new customers coming into the Fios base. Could you talk about, if at all, you are seeing some kind of transition in the existing base to these skinnier bundles? Thanks.

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

Thanks, David. On earnings per share, we started this back I think midyear in 2015 when Lowell and I started to talk about the plateau level comparable to 2015 adjusted earnings. The way to think about this is we ended 2015 at $3.99. There's $0.13 of depreciation benefit because of the Frontier assets being held for sale, so that really is a level set of $3.86.

When we talk about plateauing, we are referring to the $3.99. So when you think about this, you are going from $3.86 from a jump-off point to $3.99. The way I think about it is we are actually growing earnings in low single digits from 2015 to 2016 when you make that one-time adjustment. So we will grow through the benefit of the depreciation this year.

Some of the reasons for that, as I said on the last quarterly call, some of this is just math moving the Wireless transformation from the subsidy model to the device payment model. And, of course, the ramping of our new businesses, which I have been very clear, in the beginning these are like start-up businesses. And as with most startup businesses, you have very large losses in the beginning until you can grow the customer bases and start to generate the profitability.

Moving into the bonus depreciation, yes, we will get a substantial benefit next year, but I want to be clear that you should not anticipate that our tax -- cash tax payments will decrease in 2016. They will actually increase even with this benefit and the piece of that is because the profitability from a pretax income perspective will continue to increase. And we're also still eating through the reversal of prior-year bonus depreciations.

So from a cash tax perspective, you should expect our cash tax percentage to continue to increase closer to our effective tax rate. Now, not to the extent of the 35% to 36% guidance that I gave you, but it certainly will move from the low 20%s we realized in 2015 to the upper 20%s in 2016.

On the cord-shaving piece, as we said in our prepared remarks, we are starting to see more and more customers coming into Fios on a broadband-only basis, so just a single-play strictly with broadband. As far as our current base goes, we see a little bit of trending but not much. Most customers are depleting the voice side of the product and keeping the broadband and video side of the product at this point.

David, hopefully that answers your question. Let's move to the next one.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - *Morgan Stanley - Analyst*

Thanks very much. Good morning, Fran. You touched briefly on the auction in your commentary. I know in the past you had made some of your interest contingent on some of the rules, which we have now. Maybe you could just think about how we should be thinking about sizing your potential participation, what you need here.

There has been a lot of stories about potential asset sales over the months, most recently about data centers. Perhaps you could just talk about your philosophy now that you've done the towers; you are doing the Frontier asset. Should we expect or are you considering doing other significant asset sales over the coming year or two? Thanks.

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

Thanks, Simon. On the auction, let's just -- I'll keep this one short on the incentive auction because of a lot of rules around what I can and can't say at this point. But we will participate in the auction and I will leave it at that.

But thinking about spectrum overall, I think we have to think about the 600 megahertz which I've talked about previously and how that fits to our portfolio. We think ahead to 5G. As we said, we will be at the forefront and we are currently at the forefront globally talking about standards. We will be the first company to roll 5G out in the United States and we are currently preparing for those field trials.

The other thing I would say about 5G is we would hope that the FCC moves quickly to adopt the rules to facilitate 5G deployment. Think about 5G, it may not just be about mobility. It may be about other use cases; it's not just about mobility.

Then when we think about the unlicensed opportunity, if you were at the Consumer Electronics Show these past two weeks, there were multiple manufacturers who were running side-by-side comparisons of unlicensed, if you will, LTE or unlicensed spectrum utilized by an LTE carrier right next to Wi-Fi. It absolutely shows no interference, which is some of the rhetoric out there, and it actually showed that the comparability is it improves the Wi-Fi performance by having a managed unlicensed within the LTE carrier. Again, this just goes to continuing to work with the FCC and having them see through the release and usage of unlicensed for the LTE carriers.

Then, of course, we will continue to utilize the secondary market as we do quarter in and quarter out, utilizing swaps, which we just completed this past quarter. We're working on another swap that we will complete in the first quarter. And also minimal buys in the marketplace with smaller holders. So that's how we think about the whole spectrum asset perspective.

On the sale of assets, as Lowell and I have continually stated, we will always look for opportunities. The data centers is an exploratory exercise to see if the asset is more valuable inside or outside the portfolio. I view that asset similar to the way we view towers. Is there a way to monetize this asset that contributes value to our shareholders and gives us the capability to move that capital into higher-returning assets for Verizon?

There is no decision that has been made. This is exploratory and as we explore, if the numbers come out like it did on towers, then we will execute on a transaction. If it doesn't, then we won't.

At this point, again, we will always look at opportunities to monetize the portfolio to the benefit of our shareholders. Thank you, Simon.

Operator

John Hodulik, UBS.

John Hodulik - *UBS - Analyst*

Thanks. Fran, I think the churn below 1% was obviously a bright spot for the quarter. Is that a level you think you can maintain as you look at into 2016 given the competitive environment?

Then you mentioned some continued pressure on the service revenues looking out. Can you talk a little bit about the components driving that and when you expect to see an inflection in that metric? Thanks.

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

Sure. Thanks, John. On the churn rate, if you recall, when we sat here a year ago and we entered 2015 we said a concentration of 2015 will be to protect our customer base. And that's exactly what we executed on throughout 2015 and the execution of that will continue in 2016. The focus will be customer satisfaction and satisfying our customer base so they stay with us.

I think that's proven through our very low churn rate this fourth quarter. Even with the rhetoric from some outsiders about how they are stealing customers, the churn rate does not reflect that. And port outs are down year over year.

We are doing what we said we do around the loyalty. Customer satisfaction comes in here around our simplicity and being simple with customers so they understand what they are getting. And this goes to our loyalty base.

On the service revenue side, I guess the thing I would say on this is that again this is really to math. Math of shifting from the subsidy model with higher service revenue to a device payment model where you get a break in service revenue but you pay full price for the handset model.

As we said, we are through 40% of our customers -- we are slightly higher than 40% -- who are now on that new pricing, so you have already seen the impact of that. As I said last call, we believe the inflection point will happen at 50%, which we believe we will attain midyear.

Coming out of the fourth quarter, though, we did see a slowdown in the take rate of installment sales, but we do believe that that take rate will accelerate back up above 70% for the fourth quarter. And we're going to announce some differences here, a shortcoming that will drive some of that behavior towards that.

As you know, we continue to allow our current base customers who upgrade to select, whether they take device payment or subsidy, and what we saw in the fourth quarter was we had a higher percentage of our base stay on the subsidy model, which caused pressure on the P&L of Wireless because of the subsidy take. So having said that, John, I think as we go through the year we will be able to give you more clarity here.

But the other thing I would ask you to take a look at is the I-ARPA metric, which if you look at third quarter it went up by 0.2% and then the fourth quarter went up 0.9%. So you are already starting to see some of the underlying metrics starting to absorb some of the repricing. I will leave it at that for 2016, but I will come back to you as we break through the 50%.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - *JPMorgan - Analyst*

Thanks. So Fran, first just following up on John's question. With the current asset mix, and not just in 2016 but beyond, is it still a business that can grow well above GDP? And how far do you think above?

Second, on Custom TV. You've said in the past that you are pushing toward your minimums on some of your contracts. How should we think about that potentially impacting Custom TV or do you think you could reopen some of those contracts to let that percent go higher?

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

Thanks, Phil. The answer to the question is, yes, absolutely. And I think we have to go back to -- and start at the beginning on the whole top-line growth story.

First and foremost, I think the foundation is our network, our strategy and densification, the use of fiber. Fiber is going to be critical with the densification, dark fiber.

92% of our cell sites are already fiber enabled; the other 8% are microwave which probably won't get fiber, so when you look at it almost 100% of our cell sites are fiber-enabled. And every small cell, 100% of every small cell we deployed is fiber-backed. This is in preparation of some of the future products and services that we are looking at in conjunction with both what Marni has under IoT, go90, but also for 5G.

If you look at customer satisfaction, this goes to a big component of the low churn and how we start to increase the value to the customer so that they are willing to pay us more for increased value. The quality base also goes to this.

So when you look at wireless, they grew 1.2% here in the fourth quarter. If you look at volume overall year over year, gross adds and upgrades were down by 1.9 million. So if you just do the backwards math on that, that's in excess of $1 billion of revenue that wasn't there this year that was there last year. When you look at it, the foundation of Verizon Wireless is still very strong and we believe that we can continue to grow the Verizon Wireless revenue streams.

On Wireline, Fios is still the foundation. It's now 80% of the overall Wireline revenue. When you look at what we're doing in broadband, the pervasiveness of broadband, no one can match our symmetry on the up and downloads, so that's something that we have against our competition.

We are preparing for the over-the-top model. Custom TV is one of the things that I've said, yes, it has a limited life but you're going to see us refresh Custom TV and continue to do what consumers want, which is what they -- they want choice. They don't want to have to pay for bundles that they never use. Then, of course, stability of the enterprise business also adds to this.

Then you jump into our growth engines. If you look at AOL, AOL this quarter increased $300 million in revenue sequentially from the third quarter. It goes to the strength of the advertising model under AOL, which is why we bought them. Now some of that is seasonal, but we believe that they will continue to have strong growth into 2016.

Go90, which is still in its beginning stages, and I know we've seen some external reports on the number of downloads in excess of 2 million, but the key to us is not the downloads, the key is viewership. It's around content and we will continue to add content that is favorable to all generations of population.

Obviously we have a lot of content there for Millennials, but sports and music attain to a lot more than just Millennials, so we are attacking all viewership with this product. And we will have more to say about that probably midyear.

Internet of Things, if you walked around CES, it's all about the digital mobile world and we are in the best position to capitalize on that with our Smart Cities, Telematics, with the launch of hum. We started that in the fourth quarter and we've already seen that there are certain stores in the United States that can't keep the product within Verizon Wireless. They're continually selling out of the product. And this is a recurring revenue stream.

If you think about ThingSpace this is really the adjunct to the Consumer Electronics Show where we've opened up our platform. We now have over 4,200 developers working on that platform and that's just since October 29 of last year. So, yes, it was a transition year in 2015; it will be a transition year in 2016, but I am confident that with the strategies that we are taking that we will absolutely be a GDP growth company post 2016.

Custom TV, we talked about that. We will refresh that here in the short term to be in compliance with the contractual arrangements that we need to be in compliance with.

Phil Cusick - *JPMorgan - Analyst*

Is there a hearing that needs to happen at some point this year or a trial?

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

Relating to ESPN?

Phil Cusick - *JPMorgan - Analyst*

Yes.

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

Look, this will go its course. They're a great partner of ours; we will continue to work with them and I'm not going to speak to the actual lawsuit.

Phil Cusick - *JPMorgan - Analyst*

Thanks.

Operator

Mike McCormack, Jefferies.

Mike McCormack - *Jefferies - Analyst*

Thanks. Fran, maybe just a quick follow-up on the I-ARPA question. How fast do you think equipment revenue starts to ramp up here? I guess just thinking about the percentage of those customers making payments versus those that are on non-subsidized plans. Is that gap --there's probably some retention built into that, but I assume that gap can close over time. Just your thoughts around that.

And then just a quick other question regarding towers. We've heard a couple of your competitors sort of downplaying future tower needs and trying to bypass some of that cost. Just trying to get a sense for what you think as far as your need for towers goes.

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

On the I-ARPA, keep in mind only 29% of our customers currently today are on a device payment plan, so they are actually taking the installment plan and paying us full price for the equipment. But 40% of our customers who fulfilled their subsidy contract have moved over to that pricing, so they are getting the discount. So we're absorbing that.

As I've said, once you get to that 50% you should see that inflection point start to occur and you are already starting to see some of that in the I-ARPA-type metric. It's hard for me to forecast exactly what will happen here but the forecast that I have is at 50% you start to see an inflection point. And we will talk more about that as we go through the quarters.

As far as towers go, look, we continue to build macro towers but at a much lower rate than historically. Our focus is really around small cells, densified antenna systems, in-building. But keep in mind that each of those small cells, in-building, and antenna systems all get fiber back to a main macrocell. So the macrocells still have an important role in how you deliver traffic into those small cells.

As far as building and creating new towers, that is at a much slower rate, but the importance of the tower is still there.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - *Goldman Sachs - Analyst*

Thanks for taking the question. Fran, you had noted how churn and upgrades they were all lower year over year. It seems that across the sector activity levels have been lighter than we might've thought, whether it's churn or gross adds or upgrades.

Why do you think that is? Do you think that this is a temporary factor or do you think it's the new normal? Really I guess the question is: what do you think is going to happen in 2016?

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

Thanks, Brett. Look, 2014 was a unique year. You had a very different form factor come out from Apple, which drove a lot of traffic to that iconic device. You continue to have innovation from Samsung and LG, but we didn't have that huge change in the handset this year that we saw a year ago. So that I think affected some of the upgrade model.

But when you look at it, we still did about 1.5 million more upgrades in the fourth quarter than we did in the third quarter. So the volume of upgrades still increased; it just wasn't what it was a year ago. If you remember, I said coming into this way back in the second quarter I said I did not anticipate that the fourth quarter this year would be a similar volume to the fourth quarter of last year.

But if you go back to the previous years, I think you'll see similar lower volume years. Then you have iconic devices come out and it stimulates some usage case there. So for 2016 it's too early to tell you, but I would think that we'll see similar trends that we did in 2015.

Brett Feldman - *Goldman Sachs - Analyst*

Are you seeing any evidence that as customers move to installment plans they actually keep their devices longer?

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

Well, for our base it's too early to tell because the first generation of them are just starting to mature, so until I get some real factual data on that it's hard for me to answer. My own personal opinion here is that, if you look at history, a third of your customer base upgrades every year. I don't see that changing regardless of what plan the customer is on.

Operator

Mike Rollins, Citigroup.

Mike Rollins - *Citigroup - Analyst*

Thanks for the opportunity. Two questions, if I could. First, Fran, if you could just talk about what Verizon was able to accomplish on cost cutting in 2015 and how investors should think about that relative size in 2016. And, second, as you look across your different business segments, are you seeing any changes in the macroeconomic backdrop or a risk of a recession? Thanks.

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

Thanks, Mike. On the cost-cutting, look, I think the last three to four years we've talked about this and we are an extremely disciplined corporation as far as costs go. With the launch of our Verizon Lean Six Sigma program three years ago, that continues to maintain momentum.

We took out almost 30 million calls down from a year ago, so there's a lot of progress being made on self-serve. There's a lot of progress being made within our logistics system. This year alone we generated working capital benefits from how we handle our phone inventory.

You saw the Wireless restructure this year was the first restructure we had really since the inception of Verizon Wireless. As we go into 2016, you saw us take that severance charge and I would tell you most of that severance charge was related to headcount that was already completed in the fourth quarter.

So entering into 2016, we continue on the path that we were on. We will continue to look at customer satisfaction, more self-serve options that reduce the amount of calls that we have to take from customers. There's still a lot of work to be done around our cost structure.

If you look at Wireline, as we came into this year Lowell and I said we would improve the profitability of Wireline. That came from all the cost reductions that John and his team achieved. So we will continue on that path and I feel good about that.

As far as overall economics, I am not really seeing much of anything in the consumer spaces that we drive. I look at what everybody else looks at and we will have to wait to see where 2016 comes out, but I'm certainly not going to predict any negativism there.

Operator

Craig Moffett, MoffettNathanson.

Craig Moffett - *MoffettNathanson - Analyst*

Good morning, guys. Two questions, if I might. First, on go90, can you update us a little bit on what the early results are and what learnings you have had from go90? Just given your comments about the roughly flat year-over-year EPS and the impact that go90 might have on that, I think a lot of us have concluded that there is likely to be something significantly bigger coming this year with respect to marketing and content.

Can you at least give us a timeline for when we might see those kinds of developments on go90?

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

Sure. Thanks, Craig. When I think about the whole portfolio, go90, Verizon Digital Media Services, and AOL, obviously we just launched all these products, so there's a startup. It was the first fourth quarter that we advertised these types of launches. You are going to see that continue through the four quarters of 2016, which was not there in 2015, so there will be pressure from these start-up companies.

Our learnings on go90 are very simple. We're looking at how many times individuals revisit the platform in one day and we're starting to see some positives there. People will come in multiple times during the day and that's important because that's what's viable to the advertising community.

The whole basis here is we have to ramp viewership. I will tell you internally we have surpassed what we thought we would have at this point in time. We have set higher targets for 2016 because we need to build the viewership in a much quicker fashion. I think what you are seeing here from AOL is a very strong fourth quarter. Now there is seasonality to that, but as I mentioned, I'm looking for them to grow substantially in 2016.

So I think when you put this together, I think the top line will start to reflect some of the things that we are looking for, but it will create bottom-line pressure. These will not -- especially go90, will not be a profitable product probably within a one- to two-year horizon right now. When we launched it we said two to three, but it's probably out two years before that will become a profit contributor to the enterprise; but it will certainly build on the top-line perspective. But right now we're focused on viewership, not necessarily the profitability of the product.

So I will stop there. As I said, we will come in with much more detail probably midyear and start to give you some viewership into exactly some of the results of go90 and AOL.

Craig Moffett - *MoffettNathanson - Analyst*

Fran, related to that question, if I could, on AOL, now that you've had AOL for a while there was some talk, and I think you directly spoke, to the possibility of a Yahoo or something like that. Are there other assets that now that you've had AOL for a while you think makes sense to expand that part of your business with?

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

Look, I think we've been pretty open since we acquired AOL. We said that we would continue to add to that portfolio. We acquired Millennial, which we talked about. So, yes, there are things that we continue to look at for fill-ins, if you will.

The other that you brought up, it's intriguing, but there's really nothing to respond to at this point on that. So, look, we will continue to look at all of our options, as Lowell and I said. We will continue to look at opportunities externally and look at opportunities internally and if they make sense for the shareholder, then we will execute on those opportunities.

Operator

Amir Rozwadowski, Barclays.

Amir Rozwadowski - *Barclays Capital - Analyst*

Thank you very much. Fran, you had mentioned that you continue to look to monetize your handset receivables. I think in your prepared remarks you had mentioned that you were looking at other alternatives. Perhaps you might be able to elaborate.

We've obviously seen your competitors look to other means and funding strategies to support their businesses. So any thoughts on the potential options you were considering would be most appreciated.

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

Sure. Thank you, Amir. Just to refresh, we monetized or securitized $9.4 billion of receivables. We received gross cash of $7.2 billion. We obviously paid off some of those securitizations, so about a $5.9 billion net cash. So when you think about that, we absorbed about $3.5 billion within our working capital this year from the switch to the device payment model.

I will tell you that we have been talking to the rating agencies about different types of financing and I will probably leave it at that at this point. But we will be looking at potential public markets as well as private markets, but we will stay with the securitization model as well. So we're just looking at very different alternatives to support the program going forward, because we do believe it will continue to grow in 2016.

And more to say on that when we come to a conclusion on that one, Amir.

Amir Rozwadowski - *Barclays Capital - Analyst*

Then, if I may, just one follow-up. You folks seem to be taking the lead with discussing a number of new bandwidth-enhancing technologies and you had alluded to this on your prepared remarks around 5G developments and unlicensed spectrum.

How should we think about your ability to bolster the carriers' capacity moving forward utilizing these types of developments? And ultimately, do you believe there is a path to improving your capacity without actually having to broadly expand your spectrum portfolio at this point?

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

The answer to the question is yes. If you look at some of the small cell technology and also some of the technology that can be utilized at the cell site -- I know there's a fancy name for it, but I'm not the engineer here -- but it gives you the capability to be able to tilt antennas and turn antennas to where the capacity is.

So if you think about football game Sundays and college games, we have the capability to utilize our current resources to increase capacity without any spectrum capacity. There is a number of technologies that are coming. Obviously, when we launched 4G we said it would be 5 times more efficient than 3G. 5G is too early, but my suspicion is that we're going to see some similar benefits there from a capacity standpoint, which is one of the benefits of 5G.

So, yes, I think that if you look at spectrum, we are in a very, very good spectrum holdings, as we said with all my other comments around spectrum and how we utilize unlicensed along with what we bought in AWS and the repositioning of what we currently have on 3G over to 4G. So utilizing all of these items, we feel that we are in very, very good shape from a capacity standpoint.

Amir Rozwadowski - *Barclays Capital - Analyst*

Thank you very much for the incremental color.

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

Thank you for your questions. Before we end the call I will just turn it back to Fran for a few more remarks.

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

Thanks, Mike. Look, 2015 was a year of significant change at Verizon. And even with all that change we delivered a strong financial year, continued to invest in growing our customer base, invested in our networks, developed and expanded new businesses, and returned value to our shareholders in the form of dividends and share repurchase.

2016, we will continue what we started in 2015. We will focus on execution and growth with our three-tier strategy and heritage. We will continue to build on a strong network and customer foundation. With our foundation we will compete effectively in this dynamic marketplace.

We will bring new products and services to market and continue to be the leader in the digital-first mobile world. We look forward to maintaining our positive momentum to create value for our customers and our shareholders, and I would like to thank you for joining Verizon today. Have a great day.

Operator

Ladies and gentlemen, this does conclude the conference call for today. Thank you for your participation and for using Verizon conference services. You may now disconnect.