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VZ - Q2 2016 Verizon Communications Inc Earnings Call

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OVERVIEW:
Co. reported 2Q16 reported GAAP EPS of $0.17.
Good morning and welcome to the Verizon second-quarter 2016 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. Thank you, you may begin.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

Thanks, Tori. Good morning and welcome to our second-quarter earnings conference call. This is Mike Stefanski and I'm here with our Chairman and Chief Executive Officer, Lowell McAdam, and our Chief Financial Officer, Fran Shammo.

Thank you for joining us this morning. Given yesterday's announcement of the Yahoo acquisition, we expect this call will exceed an hour.

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. Today's presentation includes forward-looking statements about expected future events and financial results that are subject to risks and uncertainties. Factors that may affect future results are discussed in our filings with the SEC, which are available on our website.

This presentation includes non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are available 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 Lowell and Fran go through our strategy and these results, I would like to highlight a few items. For the second quarter of 2016, we reported earnings of $0.17 per share on a GAAP basis. These reported results included several significant non-operational items that I would like to highlight.

Our reported earnings include a non-cash pretax loss of $3.6 billion generated by pension and other post-retirement benefits, primarily due to the remeasurements triggered by the new labor contracts, the transaction with Frontier, and settlement accounting. The overall impact after tax amounted to $2.2 billion, or $0.54 per share.

On the balance sheet side in the quarter, employee benefit obligations were reduced on a net basis by $1.6 billion, primarily driven by actuarial valuations associated with the new labor contracts and the Frontier transaction, which were partially offset by the mark-to-market remeasurements and the assets transferred to Frontier. Year to date, unfunded employee benefit obligations have been reduced by $1.9 billion.

We incurred non-operational expenses of $1.8 billion in connection with the early debt redemption and tender offers. On an after-tax basis, these charges amounted to $1.1 billion, or $0.27 per share. Additionally, we recognized a pretax gain of $1 billion on the sale of California, Florida, and Texas wireline markets to Frontier. On an after-tax basis, the gain on sale amounted to $139 million, or $0.03 per share.

Excluding the effect of these non-operational items, adjusted earnings per share was $0.94 in the second quarter compared with $1.04 per share a year ago, or a decline of 9.6%. There were no special items of a non-operational nature in the second quarter of 2015.

Our adjusted results include the impact of the work stoppage, which at the consolidated level amounted to $420 million on a pretax basis, representing about $0.07 per share. At the Wireline segment level, before consolidating intercompany transactions, the pretax amount was $489 million. As previously stated, we will not recapture the $0.07 for the impact of the work stoppage on full-year 2016 earnings per share.

For purposes of comparability in the Wireline segment, the historical results of the operations that we sold to Frontier on April 1, 2016, have been reclassified to Corporate and Other. On June 28, we filed a Form 8-K providing the recast unaudited historical information for the past nine quarters, which can be accessed on our website. Additionally, prior-period results do not include the operations of AOL.

With that, I would now like to turn the call over to Lowell.

**Lowell McAdam - Verizon Communications Inc. - Chairman & CEO**

Thank you, Mike. Good morning, everyone, and thank you for joining us today. We had an eventful first half of 2016 marked with several strategic milestones.

We continued to evolve our Wireless pricing model and customer interface. We closed the Frontier transaction. We made major moves in our network and reached new contracts with our labor unions, all while delivering solid results in a challenging environment. We will discuss all of these in more detail in a few minutes.

In addition, yesterday we announced that we entered into a definitive agreement to acquire Yahoo's operating business for approximately $4.8 billion, a transaction that will make us an even stronger competitor in digital media. With everything that's going on, I wanted to take a few minutes at the start of this call to put these initiatives in context and tell you how we are strengthening our ability to realize our mission of delivering the promise of the digital world.

We have spoken to you before about our three-tier strategy. First, sustaining quality and performance leadership in all of our networks; second, in building new ecosystems around our broadband, video, and Internet of Things global platforms; and finally, monetizing our investments in networks and platforms through applications and content. I am very pleased with the progress that we are making across all of these fronts.
For us, delivering the promise of the digital world begins with network leadership, which has been the cornerstone of our brand since we formed Verizon in 2000. Our 4G LTE network consistently leads all external studies for quality and reliability across the country, even with the explosive growth of data usage. Over the last 16 years, we have grown from approximately 25 million customers using wireless almost exclusively for voice services to more than 110 million customers using wireless for mostly data services.

In the second quarter alone, network usage increased 44% over the prior year. To give you a perspective on traffic growth, we carry the same amount of traffic on our network in one hour today as we did 10-plus years ago in one week.

In light of this growing demand, we are continuing to invest in and evolve our Wireless network to provide the broadest, most reliable, and highest quality wireless experience for our customers. This investment includes expanding the fiber front and backhaul to support wireless network growth.

Verizon has been a leader in pushing the industry forward in every new generation of wireless technology. With 3G, we ushered in an era of wireless data. By being the first to implement 4G LTE, we changed the game for the delivery of wireless broadband, opening up new opportunities for our customers and the industry as a whole.

LTE is a growth engine for applications and devices across the ecosystem, increasing the productivity of our country. New players are entering this ecosystem every day. To make sure 4G LTE can handle our customers’ ever-increasing demands, we are challenging conventional approaches to network architecture by deploying fiber to cell sites and densifying cells to handle the constant demand on the network in high-usage areas.

We are also optimizing 4G with new techniques like centralized baseband architecture, carrier aggregation, and core network virtualization initiatives, which provide operating, capital, and spectral network efficiencies.

The balance has shifted away from building capacity exclusively through spectrum. We believe that 4G will be the base layer of our Wireless network for years to come. Moreover, our approach to network architecture is also preparing us for 5G and shaping our thinking about future investment that will drive growth across all our business and ecosystem.

You saw the first fruits of this strategy in April, when we announced our One Fiber strategy for the city of Boston. We will create a single fiber-optic network platform capable of supporting wireless and wireline technologies and multiple products. In particular, we believe the fiber deployment will create economic growth for Boston and we are talking to other cities about similar partnerships.

No longer are discussions solely about local franchise rights, but how to make forward-looking cities more productive and effective. Our announced agreement to acquire XO Communications will also be a key part of this strategy, providing us with the deep fiber assets including 40 metro fiber rings in major cities and millimeter wave spectrum in a significant part of the country that will give us a critical competitive edge.

Yesterday the FCC approved our lease arrangement with XO so that we have a clear spectrum path toward 5G deployment, which, like 4G, will be a game changer. I think of 5G initially as, in effect, wireless fiber, which is wireless technology that can provide an enhanced broadband experience that could only previously be delivered with physical fiber to the customer. With wireless fiber, the so-called last mile can be a virtual connection, dramatically changing our cost structure.

I know we heard a lot of skepticism when we formed the 5G Tech Forum last fall, with critics questioning the need for moving so soon. But as we learned from our experience with 4G, being a first mover in developing the technology and nurturing the ecosystem is the best way to ensure that our customers benefit from its capabilities.

In our labs we are able to predict and model what a future home will look like with multiple high-definition TVs, laptops, tablets, and virtual reality applications served over a wireless connection, delivered at speeds significantly higher than 1 gigabit per second. We are conducting field trials to see how the technology will perform using millimeter wave spectrum in terms of reach and propagation in real-world conditions.

Mobile use cases, which will follow toward the end of the decade, will include massive Internet of Things scale and low latency services and applications. Trade associations are already accelerating their timelines for standards, which will be good for the industry.
ecosystem, including chipset equipment and device manufacturers, is aggressively adding resources to deliver handsets and low-latency applications.

To date, we have accomplished several key milestones in moving toward 5G. Along with our Tech Forum partners, we completed radio specifications, which means that we can now test technical components for wireless fiber services. We have ongoing technical trials in several markets to accelerate the pace of innovation, and we are strengthening our partnerships with carriers and OEMs to foster the development of a global ecosystem.

So we see the stars aligning very quickly when it comes to the 5G future. We have been very pleased by the partnership with the FCC to finalize the 5G spectrum rules. All of this keeps us on track to be the first carrier to deploy a 5G network in the United States, preparing us for a fixed commercial wireless fiber launch in 2017 and laying the foundation to build mobility use cases later in the decade.

Through every generation of technology, our fundamental principles remain the same, highest quality, consistent investment, customer value, and, yes, superior execution. This dedication to network quality has created the best wireless network in the world. Maintaining and extending that leadership remains the number one priority of the Company.

With the other two tiers of our three-part strategy, we are developing the platforms, content, and applications that will drive usage on our network and monetize our investment in this world class infrastructure. Let me review our progress in these areas starting with video.

As you know, we’ve been building our video assets and capabilities for some time with a goal of building a global platform and developing new business models for reaching the digital video customer. At the heart of this video evolution are the changing ways in which younger consumers access their digital and mobile content.

Over the past several years we have dramatically expanded the ways in which we can deliver content wherever and however the digital customer wants it, including large and small bundles of linear content through FiOS TV; new and better customer experiences for FiOS using IP-based technology; over-the-top delivery of content; purchasing of AOL, with its publishing and advertising technology and content; further enhancing AOL with the Millennial Media acquisition; introducing go90 and its vast library of digital content, not only for our Verizon customers, but other carriers’ customers as well; developing a global video distribution for media companies to efficiently deliver high-quality digital content; and finally, establishing a content joint venture with Hearst through which we have invested in two leading digital brands for female and male Millennials, namely AwesomenessTV and Complex Media.

We assembled a great team and strong assets under Marni Walden. Just over the past year since the AOL acquisition, we have learned a tremendous amount about the video market and opportunities to grow in the future. Her team is focused on integrating these assets and driving profitable growth by attracting viewers through great content, which, in turn, attracts advertisers by increasing the return on their advertising dollar.

That brings us to Yahoo. We see tremendous opportunity in the digital video marketplace, which has an estimated addressable market of $180 billion by 2020.

Today that marketplace is dominated by two brands. Content creators and advertisers are hungry for alternatives as the market expands for both in-home and mobile consumption. Verizon intends to be a significant player in this space.

By acquiring Yahoo’s operating business, we are scaling up to be a major competitor in mobile media. Yahoo’s operations provide a valuable portfolio of online properties and mobile applications, which attract over 1 billion monthly active consumer views.

It also brings market-leading content, brands in sports, finance, news, and email into the portfolio. It expands our analytics and ad tech capabilities and enhances our competitive position and value proposition to advertisers. We are already seeing enthusiasm from partners in sports, news, and finance to leverage this scale in the future.

Yahoo’s operations complement AOL’s business, as well as our overall asset portfolio. The global scale, volume of customer analytics, and market reach of the combined assets will allow us to create long-term value in a less capital-intensive manner.
We look forward to working with a very talented team at Yahoo. In the months ahead we will be focused on completing the necessary regulatory process, planning for integration, and closing this cash transaction early next year. Going forward, this acquisition will put us in a great position as a top global media company and give us a significant source of revenue growth for the future.

We are also building our growth capabilities in the emerging Internet of Things market by developing business models to monetize usage on our network at the connectivity and platform layers. We had another quarter of 25% growth in revenue from the Internet of Things, which amounted to approximately $205 million in the quarter and about $400 million year-to-date in 2016. We've also seen strong demand for our telematics products, including our direct-to-consumer product, hum, and see many opportunities to expand in the market.

In June we agreed to acquire Telogis, which will advance our fleet telematics connected solutions and expand our distribution relationships while we grow our global scale. So as we are making tremendous strides strategically, John Stratton and his operations team are not taking their eye off the ball when it comes to operational performance. I am pleased with where we stand as we reach the midpoint of the year.

In Wireless, we've made significant progress in shifting away from the subsidy model with 53% of our postpaid phone base now on unsubsidized price plans. At the same time, our churn metrics continue to be the best in the industry, which is a testimony to our high-quality loyal customer base. Fran is going to cover more of that in a few minutes.

In Wireline, we completed the sale of three properties to Frontier, which concentrates our Wireline assets in the Northeast corridor, where we can further invest in fiber. We also managed through a seven-week work stoppage, ultimately reaching an outcome that benefited our employees and our business. While the strike impacted the results in the second quarter, the new labor contracts will generate approximately $500 million of cash savings over the term of the contract.

The contract benefits include workforce flexibility provisions that provide the opportunity to optimize processes and scale customer service center to better align with the business needs. Also, non-cash benefit savings primarily related to retiree healthcare will be realized. We preserved the bargained-for caps on our annual obligation for post-retirement medical benefits, which, when netted with other post-retirement benefit changes, reduced our unfunded employee benefit obligation by $4.7 billion in the quarter.

I would like to thank our management employees for stepping in and serving our customers day in and day out during the strike. We are proud that our customer satisfaction results remained strong during this time, which demonstrates not only our planning, but our commitment to placing customers first in our business.

I would also like to thank the vast majority of our associates for the respectful way in which they conducted themselves during the work stoppage. We look forward to continuing to work with our represented employees to better serve our customers and create work environments that will allow all of our employees to grow professionally.

Overall, we continue to make progress on reducing our cost structure through workforce reductions and the new labor contract benefits that we just discussed. As always, we are focused on driving efficiencies through our ongoing Lean Six Sigma program.

So as I look at the first half of 2016, I am pleased with what we have accomplished in a fast-moving challenging environment and how far we have come repositioning ourselves strategically for the next decade.

Now let me turn the call over to Fran to review second-quarter performance in more detail, starting with our consolidated results on slide 5.

Fran Shammo - Verizon Communications Inc. - CFO

Thank you, Lowell. Good morning, everyone. On a reported basis, total operating revenue declined 5.3% in the second quarter. If we exclude the second-quarter 2015 revenues from the operations that we divested and exclude this quarter's revenue from AOL, which was not part of our operations a year ago, adjusted operating revenue would have declined approximately 3.5% on a comparable year-over-year basis.
AOL, once again, delivered strong revenue growth in the quarter. In Wireless, service revenue, as expected, was pressured by the migration of our postpaid subscriber base to unsubsidized price plans. Equipment revenue was also under pressure, due primarily to lower postpaid phone activations.

Consolidated adjusted EBITDA totaled about $11.1 billion and our adjusted EBITDA margin was 36.3% in the quarter, compared to $11.8 billion a year ago. As Lowell just reviewed, we are reducing our overall cost structure by improving productivity and gaining efficiency in our operations throughout the business, which will enable us to deliver a strong earnings profile into the future.

Let's turn now to cash flows on the balance sheet on slide 6.

Cash flows from operations were $5.4 billion in the second quarter. Through the first half of the year, cash flows from operations totaled $12.8 billion, which is down $6.1 billion on a year-over-year basis, driven by the cash received from the tower transaction of $2.4 billion in the first quarter of 2015, a change in our method of monetizing device payment receivables, and an increase in cash taxes.

Most of our device payment plan receivables originated in the second quarter were retained in contemplation of an asset-backed securitization transaction the third quarter. This timing resulted in approximately $1.6 billion of working capital pressure.

Free cash flow for the first half of the year totaled $5.6 billion. Subsequent to the quarter, we completed our first on-balance-sheet asset-backed securitization transaction with net proceeds of $1.1 billion for which there was significant investor demand. Going forward, we expect to finance new device payment plan receivable origins with on-balance-sheet securitizations with a mix of bank transactions or public transactions.

Public or 144a on-balance-sheet securitizations as a funding channel provides several benefits, including diversification and lower borrowing costs with AAA rating. Favorable captive finance treatment from two credit rating agencies is an offset to the financial statement impacts of on-balance-sheet financing. The financial statements will reflect an increase in receivables as new loans are originated and debt will also reflect new securitization financing.

Going forward, the cash flow statement will reflect securitization proceeds in financing cash flow rather than operating cash flow. As a result, using on-balance-sheet financing will result in lower cash flows from operations and, therefore, lower free cash flow, but will not reduce the cash we have available to run the business as we plan to continue to securitize a significant amount of our receivables portfolio. We will provide additional disclosures on securitization in the third quarter.

Cash taxes are higher compared to a year ago as certain benefits that we realized in the prior period did not recur and timing of tax deductions for early debt retirements varied. Cash taxes will increase in the second half of the year, primarily due to the taxes that will be paid related to the sale of our Wireline operations which are approximately $3.2 billion.

Our disciplined capital allocation model demonstrates our commitment to investing in businesses for the future. Capital expenditures were $3.9 billion in the quarter and $7.3 billion for the first half of the year. While the first-half trend is lower than expected due to timing and the strike impact in Wireline, we reiterate our full-year capital guidance of $17.2 billion to $17.7 billion.

We ended the quarter with $99.7 billion of total debt, net debt of $96.9 billion, and a ratio of net debt to adjusted EBITDA of 2.2 times, which includes the liability management that we did in the quarter. We remain on track to return to our pre-Vodafone credit rating profile by the 2018 to 2019 timeframe.

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

Total Wireless operating revenues declined 4% in the quarter to $21.7 billion. Service revenue of $16.7 billion declined 5.4% for the quarter, an improvement from the year-over-year decline of 6.2% in the first quarter. Equipment revenue was $3.7 billion, down 4.1% due to lower activations.

Service revenue plus installment billings increased 2.3% to $19.1 billion in the second quarter. While service revenue will continue to be pressured by the migration of our customer base to the unsubsidized price plans, the decline has flattened as expected now that we have approximately 53% of our postpaid phone customers on the unsubsidized price plans.
We recently refreshed the Verizon plans to enable increased customer control. We believe the pricing plans are resonating with our customers, providing value and functionality. As with any new pricing plan, we expect some account optimization early on and we remain confident that we will return to year-over-year service revenue growth by the fourth quarter of 2017.

The percentage of phone activations on device payment plans was about 67% in the second quarter, compared with about 68% in the first quarter. The take rate, which was lower than our expectations, was due primarily to a higher mix of business customers in our overall postpaid phone activations for the quarter.

We expect the take rate for device payment plans for the third quarter to be consistent with recent experience. We recognize that new device launches could have an impact on take-rate levels, but at this point it is too early to forecast any changes.

During the quarter, 5.2 million phones were activated on a device payment plan. In total, we have about 31.8 million phone connections activated on a device payment plan, representing about 37% of our postpaid phone base.

In terms of profitability, we generated $10.3 billion of segment EBITDA in the quarter, an increase of 3.8%, and had a segment EBITDA margin of 47.5%, up from 43.9% a year ago.

Now let's take a closer look at Wireless additions on slide 8.

Postpaid net adds, which does not include any wholesale connections including Internet of Things, totaled 615,000. Overall, postpaid net additions declined sequentially, primarily due to increased tablet churn. Net phone additions increased sequentially to 86,000. We added 462,000 new 4G smartphones in the quarter, which were offset by a net decline of 250,000 basic phones. The remaining offset in phone net adds were 3G devices.

Tablet net adds totaled 356,000. All other postpaid devices totaling 173,000 were added during the quarter with Verizon Wireless retail hum devices being the primary driver. Net prepaid devices declined by 30,000 for the quarter, which is a significant improvement sequentially and from the prior year due to the impact new pricing plans for our prepaid market.

Postpaid gross additions were 3.7 million, down from 3.9 million a year ago and flat sequentially. Retail postpaid churn was 0.94%, up 4 basis points from the prior year. We continue to see strong retention in our phone base, which is being offset by increasing tablet churn stemming from the free tablet promotions from two years ago. We expect the higher rates of tablet churn to continue throughout the entire year.

We ended the quarter with 113.2 million total retail connections, excluding all wholesale connections. Our industry-leading postpaid connections base grew 3.9% to 107.8 million and our prepaid connections totaled 5.4 million. Let's now take a look at 4G device activations and upgrades on slide 9.

Total postpaid device activations were 9.5 million in the quarter, down 4.3% sequentially and nearly 16.2% on a year-over-year basis. Approximately 81% of these activations were phones, with tablets accounting for the majority of the other device activations. About 5.4% of our retail postpaid base upgraded to a new device in the second quarter. This represents a decline of 180 basis points.

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

Consumer revenue declined 0.3% and mass markets, which include small business, declined 1.2% on a comparable basis, excluding the property sold to Frontier. FiOS total revenue grew 3.7%. FiOS revenue was strong, even with the work stoppage and a high prior-year comparable pay-per-view fight event.

The growth in FiOS is driven by a higher customer base and the demand for higher Internet speeds. Approximately 11% of our FiOS Internet base has opted for speeds of 100 megabits or greater. We continue to see the downsizing of our video bundles and increased appetite for our custom TV package, which represented nearly 40% of FiOS video sales in the quarter.

FiOS subscriber growth was impacted by the work stoppage in the second quarter. We made significant progress on working through the backlog of new installations in June and expect to return to a normal run rate in the third quarter.
In FiOS video, net customers declined 41,000 of the quarter. FiOS Internet net adds were negative 13,000 and net broadband subscribers decreased by 83,000. FiOS video penetration was 34.6% in the quarter, compared to 35.5% in the prior year, representing a decline of 90 basis points. FiOS Internet penetration was 40.1% in the quarter compared to 39.8% in the prior year, representing an increase of 30 basis points. We believe we have an opportunity to further penetrate the markets we serve.

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

Total operating revenues for the Wireline segment declined 2.4% in the second quarter, due to technology transitions and pricing pressures. In the second quarter, global enterprise revenue declined 3.3% and, on a constant currency basis, the decline was about the same.

In our global Wholesale business, revenues declined 4.1% in the second quarter. Trends in our Enterprise global Wholesale businesses remain consistent with prior periods.

Wireline segment EBITDA margin the quarter was 14%, which includes the impact of work stoppage compared to 18.7% in the prior year. The pre-tax financial impact of the strike in the quarter was $489 million on the Wireline segment. In terms of improving the overall margin, we made improvements in cost structure by optimizing our workforce and expect benefits from the new labor contracts to be realized during the remainder of 2016 and in future years.

Wireline capitalized labor expenditures slowed in the second quarter as we prioritized maintenance and repair activities over new installations during the work stoppage. We expect capital spending levels to increase in the second half of the year as we return to normal operations after the work stoppage.

Let's move next to our summary slide.

As expected, 2016 is a significant transformational year for us. We are focused on executing operationally, strategically, and financially to deliver results today and prepare the business for future profitable growth. In the first half of the year in Wireless, we added 1.3 million postpaid net customers and stabilized our Wireless service revenue declines. In Wireline, we completed the sale of the operations in California, Florida, and Texas and negotiated new labor contracts which will have benefits into the future. We continue to be the network leader in the markets we serve and we are setting the business up for growth.

In our new businesses, we enhanced our video and Internet of Things platforms to position us for long-term growth and are demonstrating progress. We are very excited about the work that has already been done, the integration of assets that we are beginning to do, and the acquisition of Yahoo to accelerate our video platforms.

As we enter the second half of the year, we are confident in our ability to execute and drive results. We are on course for our 2016 guidance and expectations: full-year adjusted earnings to be at a level comparable to 2015, excluding the $0.07 impact of work stoppage; consolidated adjusted EBITDA margin consistent with full-year 2015; consolidated capital spending between $17.2 billion and $17.7 billion; a minimum pension funding requirement of approximately $550 million; and our effective tax rate for financial reporting purposes to be in the range of 35% to 36%. We also expect GDP-type growth in consolidated revenue for the full-year 2017.

With that, I will turn the call back to Mike so we can get to your questions.
John Hodulik  - UBS - Analyst

Good morning, guys. Maybe a couple of quick questions for Lowell.

Lowell, first of all, could you give us an early look at the synergies that you see coming with the Yahoo transaction? And with it behind you now, do you feel that you have the assets you need to execute on the new media strategy? Thanks.

Lowell McAdam  - Verizon Communications Inc. - Chairman & CEO

Good morning, John, and good morning, everyone. I understand there were lots of rumors about me announcing a big reorganization of the Company, so I'm sorry to disappoint you, but I think we have some pretty exciting things to talk about here.

First, on Yahoo synergy. Look, certainly, as we went into the auction process, we had a very good idea of what the synergies could be. I think probably we were the only significant bidder that had synergies.

So we have a good idea and we've heard numbers bantered around that are in the ballpark, but my view on this, John, is we now enter a phase where, post the auction diligence, which is certainly limited, we can go in and talk to management and see a much greater depth of information. And we will validate our plans and make our decisions.

So I think as we get closer to closing, which we expect will be either at the end of the year or early in the first quarter, we will announce those numbers. But they are meaningful, let me just put it that way.

On the "do we have the assets we need," certainly yesterday when Marni and Tim did their public interviews; we are extremely excited about the assets that Yahoo has in the areas of sports and finance and email and news. You match those up with AOL; we've just made an exponential leap in capabilities here.

But I will give you the answer that I always give you, John, when we talk about capital and you say, well, are you finally done expanding and are you going to reduce your capital? And my answer always is, I hope not, because if we do then we are standing still and this is such a dynamic environment, we should be looking for additional things to meet customers' needs.

I fully expect that when Tim and Marissa put their heads together, we will have a long list. And we will be disciplined, as we always are, and they will be good investments that will drive us to take a larger share of this growing market.

So there's been a lot made of are we going to challenge Google and Facebook in this process. I just say, look, we plan on being a significant player here. The market is going to grow dramatically.

We're a small player today relative to them. All we need to do is take more than our fair share of the growth of the market and this will be a success for us, and we certainly expect to do better than that.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery  - Morgan Stanley - Analyst

Thanks very much, good morning. Fran, I think you were one of the early ones to talk about elongating handset cycles. I think what we've seen so far with three companies reporting is very low upgrade rates, relatively low switching, but also low adds, low churn.
To what extent do you think this is typical pre-iPhone lull or do you think we are in a new environment of more subdued activity going forward? In particular, as you think about your growth, you talked about the ARPU stabilizing and service revenues returning, but you also need stronger volume growth. What can you do to stimulate more of the phone adds as we go forward here? Thanks.

And anything you can say on the data center sale as well would be appreciated.

Fran Shammo - Verizon Communications Inc. - CFO

Great, thanks, Simon. On handset cycles, so two viewpoints here. One is obviously we saw a similar trend, maybe not this dramatic, in 2014 where we saw a slowdown in the first half of the year in anticipation of iconic phones that were coming up on a two-year cycle. So I think some of it could be that.

Unfortunately for us, though, we have our first set of EIP customers coming up on their two-year anniversary and there's not enough volume yet of those customers to really get a behavior track, if you will, whether they are going to hold their phone and take a $20 to $25 discount on their bill or if they are just waiting for a new phone. So I think it's too early to tell. We will have a better feel for this as we go into the third quarter and that's why in my prepared remarks I said it's too early to re-forecast. But as I have said consistently, I think our volumes will be similar to 2015.

As far as how do we stimulate smartphone growth, look, I've been saying for over a year now that smartphone growth is going to continue to slow and we have to look at other areas for that growth. Obviously tablets being one and we have a little bit of a headwind there. But if you look at the gross adds of tablets, we added over 1 million tablets this quarter, so we are having pressure in the churn metric for that free tablet promotion that we did two years ago and we will continue to have that pressure throughout the rest of the year.

But if you look at the momentum of hum and you look at the other ads that we did, these are the types of devices that we want to add to the account to increase our revenue overall. If you look at the underlying I-ARPA, which is the installment and revenue per unit, that increased to 2.6% this quarter, so you can see the underlying revenue of our base is actually increasing. Unfortunately, you are not seeing it in the results because the math of moving from the subsidized to the unsubsidized is declining that.

The last comment I will make here on this topic is service revenue. You saw the 80 basis point improvement on service revenue, and as we have continued to say, once we crossed over that 50% mark -- and now we're at 53% of the base on the unsubsidized pricing -- we are starting to see that service revenue math take effect and that decline starting to reverse.

So 80 basis points this quarter; I continue to see that through the rest of the year we will improve. I will say that there won't be as much of an improvement in third quarter because of the new pricing and some of the optimization, but we will see improvement. And I continue to see this trend going through the end of 2017, which I'm still confident that we will show accretion at the end of 2017.

Finally, on the data center sales, we are coming to an end of the process and we will probably come to a definitive answer in the third quarter as to whether we're going to move forward or we are not. So I will hold comment for the third quarter for that.

Operator

Michael Rollins, Citigroup.

Michael Rollins - Citigroup - Analyst

If I could follow up on Yahoo for a moment, in a letter that was picked up by the press from Yahoo's CEO yesterday, it referred to Verizon's goal to get to a global audience of 2 billion users and $20 billion of revenue within the mobile media business by 2020.
I'm wondering if you could talk a little bit about that goal in a couple of respects in terms of what are the key strategies to get that growth. Is it simply just leveraging the assets you have or --? Can you give us a little more color on how you look to maybe manage them differently than they've been managed in the past?

Then secondly, how should investors think about the profitability of that type of revenue in this category over time? Thanks.

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

Let me take the strategic question and then Fran can talk a little bit more about the profit side.

Mike, I think this is similar to my answer to John's question. We've got a perspective going into this and we will refine it as we go along. But if you take a look at the interest that we have received from AOL current partners as well as new partners, we think there is a huge opportunity in the following areas.

First, in the sports area. As you know, we've got relationships with a lot of the big leagues; certainly NFL and NBA are the headliners for us. I've spoken with both Roger Goodell and Adam Silver in the last few weeks about this and I think we are very excited. And I expect over the next few months you will see more details about the plan of what we can do with their content, not only in season but out of season.

And there are other sports leagues that we have the opportunity to work with. Some of the other big names I'm not going to tip our hand here just yet, but the networks and their sports channels see an opportunity to partner with us.

They may already have NBA rights or NFL rights and we can work on streaming their games, not only through the traditional channels of FiOS, either custom TV or the full bundles, but over AOL and Yahoo and then finally over go90. So we view this as a waterfall of content moving down through our different properties.

The next one is Yahoo Finance; that's probably their strongest asset today. We learn more about that. As you look at, some of the other folks that were bidding on this, we think there is an opportunity for us to work with them in partnership to realize some of their visions and some of our visions.

Then certainly news, as you would expect, and the email platforms. We see ways that we can combine some of our assets and some of their assets -- the TechCrunch, the Engadget, The Huffington Post -- and we can drive a lot of visits to the site.

So I think the difference for us is we have a lot of -- us versus the Yahoo management, we have a lot of the relationships well established because of our FiOS and our mobile assets. And we can combine them with their platforms and their leadership expertise to deliver a very good lineup here.

So I think on the profitability side, Fran, I don't know any comments you have on that. But that's where we are headed from a strategic perspective, Mike.

Fran Shammo - Verizon Communications Inc. - CFO

Mike, what I would say is everything that Lowell said and we're looking at this as a portfolio of assets. As I said during this whole process, look, Yahoo brings viewers; viewers brings advertising; advertising brings top-line growth.

So the first thing here is to scale to drive that top-line growth. We believe that with the combination of all these assets we have a lot of revenue synergy upside, so the first will be to drive the top line and then, as Tim has shown, along with Yahoo team, we will drive the profitability that's required to generate the cash flow that we forecast. So that the top priority right now.
Operator

David Barden, Bank of America.

David Barden  - BofA Merrill Lynch - Analyst

Thanks so much, guys, for taking the questions. Maybe two if I could.

First, Fran, you highlighted a GDP level of revenue growth next year. I think in the past you've talked about a kind of mid to high single-digit normal earnings growth expectations for next year. Could you just confirm that those two are the same thing?

And then second, just I think in Lowell's commentary he referenced a view that spectrum is not necessarily the be-all end-all for creating capacity at the margin. In the notes out this morning, you noted that 93% of the data traffic is on LTE capacity. I was wondering if you could refresh us as to where or how much of your spectrum portfolio is dedicated to LTE and how much is still available to be tapped to kind of continue to support that 40%-plus growth rate in consumption. Thanks.

Lowell McAdam  - Verizon Communications Inc. - Chairman & CEO

David, thanks for your question. Let me go first on the spectrum side and then Fran can cover the first part of your question about growth rates.

Today, just to say it, about 50% of our spectrum is dedicated to 4G LTE. We still have some spectrum on 2G. We are refarming our CDMA spectrum as we go forward and I expect that we've got plenty of headroom here.

The point of my comments, and Boston is our good example there, is the farther we push fiber out into the network the more small-cell technology works for us. And the cost trade-off that we expected prior to the last auction told us that we would be better off going with the small cells than we would paying the prices that the spectrum was demanding.

At the Super Bowl last year, we went in and built out San Francisco and proved that thesis was correct. We were actually more conservative than we needed to be. The Boston effort that we've got underway now will further solidify that opinion.

Then, as we densify the network for 4G, it sets us up perfectly for deploying 5G with the millimeter wave technology. So we are extremely pleased that the FCC approved the XO lease arrangement yesterday, because now we have a clear field in front of us to not only densify with 4G, but use that same capital dollar to get the infrastructure in place for 5G. So we think we're in a very strong competitive position.

Fran Shammo  - Verizon Communications Inc. - CFO

David, on the second part, on the 2017 numbers: yes, GDP revenue growth for 2017. We have done a lot of work behind this obviously; what we've talked about around service revenue plays a big factor in this and the comps year over year. But we believe some of these other things start to really generate some top-line revenue, like IoT, 25% year-over-year growth rate now. We see that accelerating.

Tablets, we believe once we get through the churn headwind of the free promo, they will become a bigger contributing factor next year. So there's a lot of things that go into that, but we are pretty confident on that GDP growth.
Then on the bottom line, all I've said -- I've never given a percentage, but all I've said is a normal growth rate for Verizon. What that means is exclude the last two prior years where we bought Vodafone and got a 10% increment over our normal growth rate and then, of course, the prior year, which was impacted by the EIP accounting.

So that's all I've said and we'll talk more about that when we get to the first quarter of next year.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst

First of all, can you help us understand the progress on the 5G trials? What are you learning about the cost of deployment, usable distances, and speeds?

Then, Fran, you mentioned tablets are slower but you do expect a rebound once churn falls away. Do these add value? Is it mostly just tacking on, pulling those customers in more tightly, or do they actually add value economically on their own? Thanks.

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

Okay, I will take the first part again on 5G. What we've had so far, Phil, is we've got a big deployment down in Dallas working with Ericsson and Nokia. We've got several in New Jersey and some down in Virginia.

We have typically seen speeds above 1 gigabit over, let's just say, 500 yards or less, because of the combined space that we've got available to us. With that sort of speed we've been able to put up six ultra high-definition TVs, six virtual-reality units, numerous tablets, etc., so those services are only drawing in the 300 to 400 megs of throughput. So lots of headroom.

Now the process we are moving into now is actually going out into a field environment where we can cover a 200-home development and see with normal vegetation, with difference in weather patterns, where we think this -- these critical parameters are going to go. Theoretically, it looks -- 1,000 meters or so between cell sites seems to be reasonable, but again, we've got to verify that. We're going to go into some rural environments to see whether that propagation changes based on demand. We will know a lot more as we go along.

From a pure cost perspective, again I think it's a little too early to tell, but what I will tell you is about half of our cost to deploy FiOS is in the home today and the next biggest thing outside the home is the drop. And so our take is that with the router roughly costing the same -- and, remember, we wouldn't have to have an ONT as we think about it today.

So when we deploy 4G and densify that small cell can contain 5G for very little incremental cost. With the router in the house being probably less than an ONT and router combination today and losing the wiring in the house and losing the drop, we expect there to be a significant cost reduction.

But we will know a lot more as we finish these trials. I fully expect that as we wrap these trials up we will actually be bringing some analysts and some of the media to the field to take a look at these deployments so that you can judge for yourself.

Fran Shammo - Verizon Communications Inc. - CFO

Then, Phil, on the second part on tablets, so absolutely we view tablets as adding value. Traditionally you would say, well, a tablet that is added to a wireless account just gives you a minimal amount of access revenue and that's far less than a smartphone. And all that is true.
But if you look at the entire ecosystem that we are developing here, more people who have tablets we know watch more video on a tablet. And if you think about what Lowell outlined on our whole video strategy along with go90, AOL, Yahoo coming into the portfolio fold, we are trying to drive more usage into these devices and we want those users to consume content, which then ultimately drives advertising.

So we're looking at the value of these instruments, if you will, more from a holistic standpoint. Yes, today it's 11.4% of the base. I still believe that there is a huge growth opportunity here in the base with tablets and where technology is going. And that is going to generate not only access revenue on the Wireless side of the house, but it's also going to generate a lot of, if you will, MediaCo type revenue for the future portfolio of digital advertising.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - Wells Fargo Securities - Analyst

Thank you for taking the questions. Two, if I may.

Just following up on Phil's point, Lowell, you mentioned doing in Boston into other cities. Can I just explore that a little bit? Are you talking in your franchise footprint, your Wireline footprint, or going outside of that? Because I guess the logical next question would be, outside of that, how do you work with the incumbents there if you are kind of trying to cannibalize their main business?

Then, secondly, if you can offer any commentary on FirstNet, if you guys are there, and any thoughts on that. Thanks a lot.

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

Okay, first on the cities, Jennifer. Absolutely; there's no boundary here on our Wireline footprint. Obviously we have a stronger position in the Washington to Boston corridor. We can move to market more quickly, but we don't view that as a barrier at all.

In fact, we are talking to other cities. I mentioned San Francisco because we made a huge deployment with the Super Bowl and we're going to leverage that in our work with them. But there's no boundary.

Now, as far as cannibalization, there's an awful lot of dark fiber providers out there. We've had a lot of discussions with them and they are very happy to sell, and they've got very good footprints that get deep into some of these networks.

As I mentioned, we've obviously just purchased XO; 40 metro fiber rings, which get us into a very strong position. And there's companies out there like XO so we don't view any issue there.

As far as FirstNet, under federal contracting rules we really can't comment about that while there's an RFP in process so I'm sorry I can't make any comment there.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - Goldman Sachs - Analyst

Thanks for taking the question. Lowell, early on you started off talking about the importance of network. It's interesting; investors have increasingly been asking whether networks really are sufficiently differentiated versus what we have been accustomed to. And of
course, some of your competitors are arguing that actually there is not a lot of differentiation anymore and people should be more focused on things like price. So I was hoping we could come back to that.

Then just if we think about the evolution of how you've differentiated. It used to be you differentiated on the reliability of voice; more recently it's been the reliability of data and data speeds. Where is the battleground shifting and how are you going to make sure you continue to be differentiated based on where that's going?

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

Brett, thanks. You know, I think since we started with the original network reliability message back in 2000, those that weren't number one have constantly said networks don't matter. And customers have voted that networks do matter and all you have to do is look at the churn.

I would argue that if you need to sell your product at half of what Verizon sells theirs, that's proof alone that networks matter if you have to take that sort of a haircut. I know it's shocking, but occasionally advertisements are out there that aren't completely truthful. But that's the world that we live in.

As far as differentiation, as we say around the business, I think we've said this in other -- I don't think it's made it to an ad yet, but "can you hear me now" has really moved to "can you see me now." And that's because we've moved away from voice being a channel and an application by itself on these networks to it just rides the data stream.

And so the throughputs, the latency, that's where the battleground shifts. How we stay ahead is by densifying the 4G LTE network, but then driving very hard to 5G. Because we have seen this time and time again throughout the history of Verizon, and I would argue throughout the history of wireless, is if you build it they will come. And the more we build, the more speeds that we deliver, the more ubiquitous the network is, the customers just soak up that broadband capacity.

Verizon has always been the one that is pushing the envelope here and we continue to do that. So I hope everyone on the call sees that by aggressively moving to densification and then using that same infrastructure to build out 5G, Verizon is going to stay on the leading edge for the next decade.

Operator

Craig Moffett, MoffettNathanson.

Craig Moffett - MoffettNathanson - Analyst

Thank you, two quick questions if I could. Lowell, can you talk about the FCC's privacy NPRM and what could be significantly stricter rules for ISPs like Verizon relative to edge providers like Google or Facebook? Did that impact your thinking about what you could pay for Yahoo and how you monetize Yahoo in any way?

Then second, just a more tactical question. Can you talk about the FiOS installation backlogs coming out of the work stoppage and what we can expect with some rebound there?

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

Good morning, Craig. So on the FCC privacy NPRM -- and I would also apply this to the set-top box side. You know we are not a big fan of regulation in general; we would rather let the markets work. But if there's going to be regulation, then we think it ought to be for all the players in the ecosystem.
And I know, and I’ve talked with Tom Wheeler and I have great respect for what he is doing. He has only got so many tools in his toolbox to help set some of the standards here, but we are encouraging a broader action here that might involve the FTC or others so that everyone in the ecosystem is treated the same. And I think that's our philosophy on set-top box; that's our philosophy on privacy.

Did it impact us on Yahoo? No, not particularly. We look at that as a standalone business. Certainly, the regulatory environment always enters into your thinking, but we would do Yahoo regardless of however that NPRM turns out and we think it's going to be a dynamic business for us going forward. So I hope that helps.

Fran Shammo - Verizon Communications Inc. - CFO

Craig, one thing on the FIOS installation backlogs, yes, obviously coming out of the -- when we settled with the representative employees there was a large backlog. I would tell you, as we sit here right now today, that backlog is down to a normal, but I would say that in my prepared remarks I said we would get back to a normal growth in the third quarter.

But I will caveat that comment and say that, look, during the strike we discontinued all advertising and it takes about 60 to 90 days to ramp that backup. So albeit the third quarter will be more positive quarter for us, it probably won't be as much as a normal third quarter for us. So a little less than normal and then we feel that we will be back in stride by fourth quarter.

So that kind of lays the land of how we think about FIOS backlog and installation going forward.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

We have time for one last question if you can place that through.

Operator

Tim Horan, Oppenheimer.

Tim Horan - Oppenheimer & Co. - Analyst

Thanks, guys. Fran, between 5G and if you look at platform and solutions, how much could this drive your overall revenue growth in 2018, 2019? Is this enough to drive almost all the GDP-like growth that you are looking for?

And just maybe on the platform side, can you talk about what partners really like most about the platform and what else you are looking to do to it to kind of make it unique to attract more content partners? Thanks.

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

I'll let Fran take the first part there, Tim. The second part I assume you're assuming Yahoo, right?

Tim Horan - Oppenheimer & Co. - Analyst

Correct, sorry. And AOL.
Look, I think the items that I mentioned around the sports, finance, and news are really the big items there. If you look at Tim's numbers, he is in the hundreds of millions of users. Yahoo is well over 1 billion users. So you start putting those numbers together and there's some significant reach here.

I think every content provider, and I think it's fair to say whether you are an advocate for the 300 channel bundle or over-the-top, you realize that this is moving more and more toward digital distribution. And the partnership of AOL and Yahoo gives them the ability to reach those specific customers.

If you look at our purchase of Complex, Complex has more visitors per month now than ESPN does in that male Millennial and AwesomenessTV has the same sort of numbers for female Millennials. So it gives -- whether you are thinking you are part of a large network sports distribution or you are the actual league or you are trying to deliver finance or other news, being able to tap into that is a huge opportunity.

The big advertisers have come to us saying that they have more ads to place than they have good places to put them and so you will hear from us over the next several months some partnerships and some agreements to place ads with us.

Then the final, probably obvious one to everyone, but we have 113.2 million mobile users and people are accessing all of this content via their mobile device. We will be one of the few that can deliver advertising and content across the home, across the mobile device, and across the Internet. We think that puts us in a very, very strong position.

Fran Shammo - Verizon Communications Inc. - CFO

Then, Tim, on the second part of this, I can honestly tell you that within the comments I made there is actually nothing related to 5G as far as revenue goes. And the reason for that is because we looked at 2017 as a development year for 5G.

By the time that we get the licenses -- now we've got a great ruling yesterday by the FCC on allowing us to use the leases, so that could accelerate some of that. But I will tell you, to get to a commercial launch and actually start to generate revenue; I think that will come in either very late 2017, early 2018. But there is nothing in the forecast right now based on the guidance I gave.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

Okay, that's all the time for questions, but before we end the call I would like to turn it back to Lowell.

Lowell McAdam - Verizon Communications Inc. - Chairman & CEO

Okay. Thank you, Mike. I would also like to thank Fran for taking us through the results and, all of the analysts, I appreciate your questions. I wish we could have gotten to more, but Mike will be available throughout the day.

I know we also have a lot of reporters on the phone and Jim Gerace and our public relations team will be available to answer your questions. Both Fran and I will be out visiting with our large investors over the next several weeks, so we expect to be able to tell our story and answer more questions on a number of fronts here.

I realize that it's been a long call today and we covered a lot of topics, both operationally and strategically. But given what we said last year about 2016 being a plateau for us on earnings and given the acquisitions that we have completed, obviously Yahoo the most significant now in front of us, we thought it was good to give you this sort of an overview and update.

Before we end, I just want to make sure we have a few points that don't get lost. The team is very focused on delivering on our fundamental operational execution. We continue to be a leader in network quality and customer loyalty and in financial performance.
On the strategic front, obviously we are aggressively building new businesses with revenue and ecosystems that are expanding the industry and enhancing the revenue profile of the Company. Certainly we don't kid ourselves about execution. We have been executing, bringing new businesses into the portfolio since we started this back in 1999, but just as we have in the past, we are determined to lead the next growth surge and create value for our shareholders. Hopefully, after today you see that path as clearly as we do.

So thank you all for covering Verizon and have a great day.

Operator

Thank you, ladies and gentlemen. This does conclude the conference call for today. Thank you for your participation and for using Verizon conference service. You may now disconnect.

Thomson Reuters Editor

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Yahoo! Inc. ("Yahoo") will be filing with the Securities and Exchange Commission (the "SEC") a proxy statement regarding the proposed sale of Yahoo’s operating business to Verizon Communications Inc. ("Verizon") and related transactions, the definitive version of which will be sent or provided to Yahoo stockholders. BEFORE MAKING ANY VOTING DECISION, YAHOO'S STOCKHOLDERS ARE STRONGLY ADVISED TO READ YAHOO'S PROXY STATEMENT IN ITS ENTIRETY (INCLUDING ANY AMENDMENTS OR SUPPLEMENTS THERETO) WHEN IT BECOMES AVAILABLE AND ANY OTHER DOCUMENTS FILED WITH THE SEC IN CONNECTION WITH THE PROPOSED TRANSACTIONS OR INCORPORATED BY REFERENCE THEREIN BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTIONS. Investors and stockholders will be able to obtain (when available) a free copy of Yahoo’s proxy statement, any amendments or supplements to the proxy statement, and other documents filed by Yahoo with the SEC (when available) in connection with the proposed transactions for no charge at the SEC’s website at www.sec.gov, on the Investor Relations page of Yahoo’s website investor.yahoo.net or by writing to Investor Relations, Yahoo! Inc., 701 First Avenue, Sunnyvale, CA 94089.

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