VZ reported 4Q14 GAAP loss per share of $0.54. Expects 2015 consolidated revenue to grow at least 4%.
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PRESENTATION

Operator
Good morning and welcome to the Verizon fourth-quarter 2014 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, David. Good morning and welcome to our fourth-quarter earnings conference call. This is Mike Stefanski and I'm here with Fran Shammo, our Chief Financial Officer.

As a reminder, our earnings release, financial and operating information, the investor quarterly, and the presentation slides are available on our investor relations website. Replays and a transcript of this call will 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 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 to our website.

Before Fran goes through our performance results, I would like to cover our earnings reconciliation for the fourth quarter and highlight a few special items. These are displayed on slide 3.
For the fourth quarter, we reported a loss of $0.54 per share on a GAAP basis. This reported result includes several significant nonoperational items that I would like to highlight. The largest item is our year-end mark-to-market adjustment of pension and OPEB liabilities.

This year we recorded a pretax expense of $7 billion to increase our pension and OPEB liability. This adjustment, which was primarily non-cash, was caused by changes in the discount rate, the adoption of new mortality tables, and other actuarial assumptions. We also incurred pretax expenses of $502 million related to severance costs under our existing separation plans. On an after-tax basis, these two charges amounted to $4.7 billion, or $1.12 per share.

We also incurred nonoperational expenses of $872 million in connection with early debt redemption and other costs. On an after-tax basis these charges amounted to $528 million, or $0.13 per share.

Details regarding the income statement line item effects for these items are available on our website in the financial and operating information and non-GAAP reconciliation schedules.

Excluding the nonoperational charges of $1.25 per share, adjusted earnings per share was $0.71 in the fourth quarter. This compares with adjusted EPS of $0.66 a year ago, an increase of 7.6%. For the full year, adjusted earnings per share was $3.35 compared with $2.84 in 2013, an increase of 18%.

Keep in mind that the $3.35 adjusted EPS does not reflect full ownership of Verizon Wireless from the beginning of 2014 since the transaction closed on February 21. The results and growth rates disclosed in our presentation slides and remarks exclude the effects of the nonoperational items and are, therefore, on an adjusted basis. Also, the growth rates we provide are on a year-over-year basis unless otherwise noted as sequential.

I would like to remind everyone that due to the FCC’s rules, we cannot discuss or answer any questions related to the auction or AWS-3 spectrum. When the rules permit, we do plan to provide you with an update on our participation.

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. 2014 was a great year of execution and achievement for Verizon from both a strategic and financial perspective.

We delivered strong operating and financial performance and further demonstrated our ability to compete effectively in any environment. Strategically, our most notable accomplishment was completing the transaction for full ownership of Verizon Wireless. We closed the deal in late February, providing immediate earnings accretion and full access to the cash flows of what we believe is the best wireless asset in the world.

Throughout the year, we continued our steady and consistent investment in our networks and platforms, which are critical to driving profitable growth in the future. Our strong cash generation enabled us to invest $17.2 billion of capital and return value to shareholders through dividend payments, which totaled $7.8 billion for the year.

Last September our Board of Directors approved a 3.8% dividend increase, raising the annual amount to $2.20 per share. At the same time, we are investing and innovating for the future through new growth businesses and integrated product development efforts in rapidly-evolving markets like mobile video and the Internet of Things.

The foundation of our continued success is network excellence, which is the hallmark of the Verizon brand. We believe that steady and consistent network and platform investments provide the foundation for innovative products and services which will fuel profitable growth.
The depth and breadth of our networks provide the fundamental strength and basis for our competitive advantage. Our industry is strong and demand is growing, with customers using wireless and broadband even more and in different ways than ever before. Our competitive position is very strong and we are well-positioned from a strategic standpoint to capitalize on these market trends.

In Wireless, we had another exceptional year of quality connections, growth, and profitability. Retail postpaid net adds totaled 5.5 million for the year, with 2 million coming in a highly competitive fourth quarter that featured heavy promotional activity. Postpaid activations, gross additions, upgrades, and net adds all grew by double-digit percentages in 2014.

Total operating revenues grew 8.2% for the year and our EBITDA service margin was 48.5%, even with the short-term pressure of significant device volumes in the fourth quarter.

In Wireline, consumer revenues grew 5% for the year, driven by our FiOS platform. In 2014 we continued to increase penetration in existing markets and ended the year at 41% for Internet and just under 36% for video. Our sharp focus on productivity improvements and operating efficiency resulted in an 80 basis point expansion of our EBITDA margin to 23.2% for the full year.

Now let’s get into the fourth-quarter and full-year performance in more detail, starting with our consolidated results on slide 5.

On a reported basis, total operating revenue grew 6.8% in the fourth quarter. For the full year we added $6.5 billion to our top line, representing 5.4% growth, which exceeded our guidance of 4% consolidated revenue growth for 2014. If we exclude the prior-period revenues from the public sector business we sold, the comparable growth rates would have been 7.3% for the fourth quarter and 5.7% for the full year.

Our consolidated revenue growth continued to be driven by Wireless and FiOS. In the fourth quarter, growth was favorably impacted by increased Wireless equipment revenue, due to the significant 4G device activations.

New revenue streams from the Internet of Things and telematics are beginning to emerge. In 2014, these revenues totaled about $585 million, with growth of more than 45%.

There are countless innovative technology solutions being developed in the Internet of Things ecosystem across multiple industries. A great example of this was unveiled last week at the North American International Auto Show where we announced Verizon Vehicle, a powerful new connected-vehicle service. This unique aftermarket solution modernizes traditional roadside assistance, while enhancing driver safety and convenience.

We expect this service to launch commercially in the second quarter. The addressable market is more than 200 million vehicles on the road today that are not connected to the Internet or have a GPS unit. We believe that this large unserved market stands to greatly benefit from this new car wireless connectivity solution.

In addition to top-line growth, we continue to focus on driving process improvements and cost efficiencies through our Verizon Lean Six Sigma program. Consolidated adjusted EBITDA totaled $43.3 billion in 2014, an increase of 2.9% and our adjusted EBITDA margin for the full year was 34.1%.

Let’s take a look at our cash flow results on slide 6.

As I previously noted, the transaction to acquire full ownership of Verizon Wireless created a lack of comparability between the current and prior periods in our statement of cash flows.

In 2014, cash flows from operations totaled $30.6 billion. In addition to incremental cash, interest, and tax payments, we made $1.5 billion in pension contributions that we did not have to fund in 2013. In spite of these additional cash outlays and higher capital spending, free cash flow totaled $13.4 billion for the year.
Our capital program was consistent with our guidance of around $17 billion for the year with improving capital efficiency. In total, capital expenditures were $4.6 billion in the fourth quarter and $17.2 billion for the full year, up 3.5% from 2013. Our annual CapEx to revenue ratio was 13.5%, an improvement from 13.8% in 2013.

The pace of capital spending in Wireless was very consistent throughout all four quarters of the year. Wireless CapEx was $2.7 billion in the quarter and $10.5 billion for the full year. We continue to invest the necessary capital to proactively stay ahead of demand.

Our investments are focused on adding capacity to optimize our 4G LTE network, primarily by increasing network density. We are deploying existing AWS spectrum in addition to utilizing small cell technology, in-building solutions, and distributed antenna systems.

As I am sure you have seen from our advertising, we now have deployed AWS, or XLTE as we have branded it, in more than 400 markets, effectively doubling our existing capacity. And despite what others claim about certain aspects of their networks, when you look across the entire nation and consider all the relevant performance metrics, Verizon has the nation’s largest and most reliable 4G LTE network. We are consistently acknowledged as the performance leader in national studies conducted by widely recognized third-party organizations.

In Wireline, capital spending totaled $1.6 billion in the quarter and $5.8 billion for the year, down 7.7% from 2013. Our balance sheet remains strong and we continue to have the financial flexibility to grow the business and pursue our strategic goals.

We ended the year with $113.3 billion of gross debt and $102.7 billion of net debt. We significantly improved the maturity profile of our debt portfolio during 2014 through various debt market transactions. The ratio of net debt to adjusted EBITDA was 2.4 times. We remain committed to getting back to our pre-transaction credit rating profile in the 2018 to 2019 timeframe.

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

Our Wireless strategy is built on making consistent network investments and providing a compelling value proposition to our customers. Our investment strategy is focused on adding network capacity ahead of accelerating demand, which is driven by increasing 4G device adoption and higher customer usage. Wireless revenue growth, profitability, and cash flows continue to be driven by our high-quality retail postpaid customer base.

In 2014 we strengthened the overall quality of our customer accounts. We added 24.7 million 4G devices into our postpaid connections base, representing annual growth of about 58%. In addition, we increased the number of More Everything shared data plans to 61% of total accounts. The average connections per account grew 4% and ARPA plus Edge installment billings increased by more than 5% in 2014.

As I stated coming out of the third quarter, we expected and closed the year with a very high volume quarter. Total postpaid device activations in the fourth quarter were unprecedented, totaling 15.3 million, up nearly 34% over last year. More than 13 million were phones, driven by iconic smartphone launches from both Apple and Samsung.

To give some historical perspective, these phone activations were 1.5 million higher than the fourth quarter of 2012, which at that time was a record high because it was the first time a 4G iPhone or a free 3G iPhone was available on our network. The usage characteristics of these iconic 4G smartphones also generates stronger returns and a higher NPV.

Our fourth-quarter promotions were successful, driving a sequential and year-over-year increase in gross adds, net adds, and upgrades. This customer growth sets us up very well for profitable growth in 2015 and beyond as we drive usage and leverage the efficiencies of our LTE network.

Total Wireless operating revenues were $23.4 billion in the fourth quarter, up 11%. For the full year operating revenues totaled $87.6 billion, representing growth of $6.6 billion, or 8.2%.

Total Service revenues grew 2.8% in the fourth quarter and 5.2% for the full year. Verizon Edge installment billings totaled $443 million in the quarter and $976 million for the full year. Service revenues plus Edge installment billings grew 5.2% in the fourth quarter and 6.6% for the full year.
As we expected, the percentage of phone activations on the Edge program increased to about 25% in the fourth quarter. We ended the year with slightly more than 7 million phones on Edge, which is just over 8% of our postpaid phone base.

In terms of profitability, we generated $7.7 billion of EBITDA in the quarter and $35.2 billion for the full year, an increase of more than $1 billion, or 3%. Our EBITDA service margin for the fourth quarter was 42%, due to the significant device volumes. For the full year, the EBITDA service margin was 48.5%, compared with 49.5% in 2013. The full-year EBITDA margin on total Wireless revenue was 40.2% compared with 42.2% for 2013.

Now let's turn to a more detailed look at Wireless revenue per account, beginning on slide 8.

Retail postpaid service revenue per account, or ARPA, grew 1% in the fourth quarter and 3.9% for the full year. If you add the Edge installment billings to ARPA, the growth rates increased to 3.5% for the quarter and 5.3% for the full year.

We ended the year with 35.6 million postpaid accounts, an increase of 1.5%. The number of postpaid connections per account grew to 2.87, up 4% from a year ago.

As I said, the number of customers accounts on More Everything shared data plans increased from 46% to 61% of total. As you would expect, the average number of connections in More Everything plans are higher at 3.06 per account and grew faster, up more than 7%. And the average data usage in these accounts has increased by about 50% in the past year.

Let's take a closer look at connections growth on slide 9.

We ended the year with 108.2 million total retail connections. Our industry-leading postpaid connections base grew 5.5% to 102.1 million and our prepaid connections totaled 6.1 million.

As we said, 2014 was a year of historical connections growth. Postpaid gross additions were 5.4 million in the quarter, up 25.5%. For the year, postpaid gross adds totaled 17.8 million, up 18% from 2013 and 20% higher than 2012.

In terms of the gross add mix in the quarter, 55% were smartphones and about 37% were Internet devices, primarily tablets. About 6% were basic phones. This percentage mix is also representative of the full year.

As we said in our updates, we did experience an elevated rate of retail postpaid churn in the fourth quarter at 1.14%. Throughout the year, we maintained a disciplined approach to customer acquisition and retention, with a focus on attracting and retaining high-quality customers. Within the heightened amount of phone activity in the fourth quarter, we are pleased with the overall improvement in the quality of our phone base.

Our retail postpaid net additions of 2 million in the fourth quarter were up 26% year-over-year and 31% sequentially. Our 5.5 million postpaid net additions for the year compare favorably with the 4.1 million in 2013 and 5 million in 2012.

As far as the postpaid net add mix, the fourth quarter included 1.5 million new 4G smartphones and 1.4 million 4G tablets. Postpaid phone net adds totaled 672,000 as the 1.5 million 4G smartphones were offset in part by net declines in basic and 3G smartphones.

Full-year net adds of 5.5 million included 4.6 million 4G smartphones and 4.3 million 4G tablets. The offset to these additions were net declines in basic phones, 3G smartphones, and non-tablet Internet devices.

Let's now turn to slide 10 and take a look at device activations and our success in driving 4G adoption and usage.

Total postpaid device activations totaled 15.3 million in the quarter, up nearly 34%. For the full year, postpaid activations totaled 48.1 million, up 16% from 2013. About 85% of these activations were phones and the rest were mainly tablets.

4G LTE devices now comprise 66% of our retail postpaid connections base. This strong device adoption continues to drive increased usage.
We ended the year with 67.7 million smartphones in total, about 80% of which were 4G. Smartphone penetration increased to 79% of total phones.

About 75% of our phone activations in the quarter were customer upgrades. In total, about 9.8% of our Retail postpaid base upgraded to a new device in the fourth quarter. As you would expect, a vast majority of these upgrades were 4G smartphones.

Most of our smartphone upgrades represent an incremental revenue opportunity for us. 1.2 million were upgrades from basic phones. About 46% of the remaining smartphone upgrades were 3G to 4G, which we monetized through higher data usage and a lower cost to serve. We also continued to successfully identify and retain a high percentage of what we call high-risk/high-value accounts.

Looking ahead, we still have a sizable quality upgrade opportunity with about 13 million 3G smartphones and 18.5 million basic phones remaining in our postpaid connections base. We are very focused on this opportunity to upgrade customers and protect our high-quality postpaid base.

In addition, we also have a profitable growth opportunity with further penetration of tablets. We ended the year with about 8 million postpaid tablets in our connections base. Tablets have expanded the market for postpaid devices and provide us a good value through increased data consumption and lower churn at the account level.

Data and video usage on our network continues to rise. About 84% of our total data traffic was on the 4G LTE network. We are handling this demand and, by our own measures, the network performance continues to improve.

Let’s move next to our Wireline segment, starting with a review of our consumer and mass markets revenue performance on slide 11.

In the consumer business, we continue to see positive revenue trends, driven by FiOS. In fact, we have posted 10 consecutive quarters of revenue growth in excess of 4%. In the fourth quarter, consumer revenues grew 4.1% and for the full year were up 5%, exceeding our guidance of at least 4% growth.

Mass markets, which include small business, grew 3% in the quarter and 3.8% for the full year. FiOS now represents 77% of consumer revenue.

In the fourth quarter, FiOS consumer revenue grew 11.1%, driven by a combination of customer growth, pricing actions, and increased FiOS Quantum penetration. At the end of the year, 59% of our FiOS Internet customers subscribed to the data speeds higher than 50 mega bits per second. This is up from 46% at the end of 2013.

Throughout the year, we continued to improve the customer value proposition, driving better investment returns by creating new and innovative services on our FiOS platform. During 2014 we introduced FiOS Quantum TV. Another differentiated offer was our SpeedMatch service, which increases upload speeds to match their download speeds.

In December we introduced our FiOS Quantum Gateway, our new router that delivers America's fastest Wi-Fi. You will begin to see more marketing of this router and its capability shortly. Looking ahead, our focus will remain on driving higher penetration in existing markets, which in turn will generate profitable growth and further improve our investment returns.

In broadband, we added 145,000 net FiOS customers in the quarter and 544,000 for the year. We have a total of 6.6 million FiOS Internet subscribers, representing 41.1% penetration, which is up 160 basis points for the year. Overall net broadband subscribers increased 59,000 in the quarter and 190,000 for the full year.

In FiOS video, we added 116,000 net customers in the quarter and 387,000 for the year. We have a total of 5.6 million FiOS video subscribers, which represents 35.8% penetration, an increase of 80 basis points in 2014.

In terms of our network evolution initiative, we converted an additional 52,000 copper customers in the quarter, bringing our year-to-date total to around 255,000. In total we have converted more than 800,000 customers to fiber since we started this initiative in 2011.
Aside from the maintenance savings and improvements in customer satisfaction, conversions to fiber also provide a long-term opportunity for customers to purchase FiOS services, which result in additional recurring revenue. In 2015, we plan to convert another 200,000 copper customers to fiber. During 2014, we also continued our consolidation efforts around central offices, which will create additional efficiencies.

We have a strong commitment to customer service and have implemented several new frontline tools that are improving efficiency and increasing customer satisfaction. While we benchmark well against the competition, we have more work to do in 2015 to take our performance to the next level.

Let’s turn to slide 12 and cover Enterprise and the Wholesale business. In the Enterprise space, we continue to work through secular and economic challenges. In the fourth quarter, Global Enterprise revenue declined 4.6%, which included about $30 million of pressure from FX. For the full year, revenue of $13.7 billion was down 3.5%.

The overall story is unchanged as declines in legacy transport revenue and CPE continued to outweigh growth in the newer and more strategic applications, which are smaller in scale.

Strategic services grew 1.5% in the quarter and 2.3% for the year. This category includes both the IP layer and applications such as data center, cloud, security, and managed and professional services. Revenue from services in the IP layer has been impacted by competitive price compression, which is offsetting growth in application services.

In our Global Wholesale business, revenues declined 5.8% in the quarter and 5.6% for the full year. On the positive side, healthy demand for Ethernet services continues, but revenue declines from price compression, technology migration, and other secular challenges more than offset this growth. Total operating revenues for the Wireline segment were down 1.6% in the quarter and 0.5% for the full year.

In terms of profitability, EBITDA increased 4.3% in the quarter and 3% for the full year. The EBITDA margin was 23.9% in the quarter and 23.2% for the year, up 80 basis points from 2013.

While we are making steady progress in the Wireline business and achieved our goal of expanding margins, we are far from satisfied. There is more work to do to drive sustainable improvements in both revenue growth and profitability. Our path to improve profitable growth includes driving further FiOS penetration and improving operating and capital efficiency.

In the Enterprise and Wholesale business we are changing our revenue mix toward newer growth services like cloud, security and professional services.

On the cost side of the equation, we have realized many noteworthy process improvements and efficiency gains utilizing our Verizon Lean Six Sigma principles. We are confident that this continued focus will improve our overall cost structure, ultimately resulting in a much stronger Wireline business.

Let’s move next to our summary slide.

Our operating and financial performance in 2014 demonstrated once again that we are in a strong market position with a proven ability to compete effectively and execute our strategy. Our high-quality customer base and superior networks are the hallmark of our brand and provide the fundamental strength upon which we will build our competitive advantage.

2014 was a remarkable year from a financial viewpoint. We delivered 18% growth in adjusted earnings per share, with very strong cash flows. We executed a strategically important $130 billion transaction through a combination of debt and equity.

Our strong cash generation allowed us to invest $17.2 billion in capital, pay $7.8 billion in dividends, make incremental cash interest and tax payments, and redeem higher coupon notes in the course of restructuring our debt maturity schedule. In addition, we declared a 3.8% dividend increase and improved our cash position since the closing of the Vodafone transaction.
Our customer growth in the fourth quarter, particularly in Wireless, gives us a great confidence heading into 2015. In terms of our 2015 outlook, it is difficult to predict the competitive intensity of others, particularly in Wireless. However, we have faced highly competitive wireless environments before and have always been able to successfully and profitably grow the business because our customers understand the value of our services.

In this environment we will continue to protect our base by focusing on net adds and upgrades that make financial sense for our business. We will also continue to focus on growing in the right customer segments while at the same time creating new revenue streams for the future.

Over a sustained period of time, our industry is governed by a free cash flow dynamic. To be successful, companies need to generate free cash flow which can be invested in their networks to attract and retain customers by providing a quality experience.

In that context, we are targeting the following for 2015: consolidated revenue growth of at least 4%; sustained profitability with a consolidated adjusted EBITDA margin at a level consistent with our full-year 2014 performance; strong free cash flow generation with consolidated capital spending of between $17.5 billion and $18 billion; and a minimum pension funding requirement of approximately $700 million.

In terms of income taxes, we realized a cash benefit in 2014 due to the extension of bonus depreciation which will also have a carryover benefit in 2015. However, with a full year of 100% Wireless net income, we expect total cash income taxes to increase in 2015. We also expect our effective tax rate for book purposes to be in the area of 34% 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

Thank you, Fran. David, we are now ready to take the first question.

**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions) Phil Cusick, JPMorgan.

**Phil Cusick** - JPMorgan - Analyst

Fran, I guess to start -- speaking of free cash flow needs in the wireless industry, can you help us range your 2015 free cash flow given the commentary on higher cash taxes, pension expense, EIP, and CapEx?

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

Thanks, Phil. Not going to get into specific guidance on free cash flow, but you can see what we generated this year. I have guided you to a consistent EBITDA margin on a growth rate of a revenue of at least 4%, and I want to stress that at least 4%.

The other thing is I think that cash taxes at this point, given where we are, if we don't get bonus extension from 2015 into 2016 then obviously that puts more pressure in 2016 on cash taxes as well. So I'm not going to get into specific guidance on that metric, but I think I have given enough to put us in the ballpark.
Phil Cusick - JPMorgan - Analyst

Maybe I can try again. Given the revenue growth, can you talk about your assumptions on the Edge mix in 2015? So how much of that revenue growth should we think about as coming from equipment revenue that is more recognized than cash? Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Yes, so I think on the revenue growth side of at least 4%. If you think about that metric, what we are planning for right now is that our Edge take rate probably increases to around the 34%, 35% take rate. So some of that will be equipment revenue.

But I think what you have to focus in on is if you look at the service revenue component, you look at the recurring revenue of FiOS, so if you look at the recurring revenues of this business, 4%-plus is an achievable metric, but obviously equipment revenue will play a factor in that. But keep in mind, as we start to go out into the future on the installment sales, the installment sales will really neutralize themselves over a two-year period of time, if you think of it that way.

So as we collect more on installment sales we are putting more on, but the cash flow is starting to catch up with it. So I would keep that all in mind.

The other thing, too, is from a cash flow perspective we are looking at alternatives around the receivable as this grows. So you could see us do things around securitization in the future; not that we are announcing anything today, but that is a possibility that we are looking at as we continue to grow that mix on the Edge program.

Phil Cusick - JPMorgan - Analyst

That helps. Thanks, Fran.

Operator

Simon Flannery, Morgan Stanley.

Simon Flannery - Morgan Stanley - Analyst

Great. Thanks very much. Good morning. Fran, you talked in your summary comments about your focus on nonstrategic asset sales. There’s been a lot of talk for -- about towers for a while. We haven’t seen anything yet.

Can you just talk about towers and then access lines, data centers, enterprise; how you are thinking about some other -- some of these assets and what we should expect going forward? Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Look, I think we’ve talked about a lot of this in the past, but at this point we are aware of all the rumors in the marketplace. Naturally we don’t have any comment on any specific rumors, but we have consistently said that we are always looking at all kinds of strategic transactions.

And if they are the right transactions and provide value to our shareholders, we will execute on those transactions. And at that time we will come back to you and announce our strategy around that. But beyond that, there’s really nothing else to say on this subject.
Simon Flannery - Morgan Stanley - Analyst

So just to say, you expect to make some transactions this year or is it just dependent on the terms?

Fran Shammo - Verizon Communications Inc. - EVP & CFO

I think what I would say is we continue to look at all strategic availability, and if something makes sense, then we will execute on that strategic initiative.

Simon Flannery - Morgan Stanley - Analyst

Great, thank you.

Operator

David Barden, Bank of America Merrill Lynch.

David Barden - BofA Merrill Lynch - Analyst

Thanks for taking the questions. Fran, just on your comments about free cash flow kind of governing the competitive intensity in this space, could you talk about the assumptions that you are making for your 2015 expectations?

Are you assuming that competition continues at its current course and speed? Does it level out at current levels? Or are you assuming that maybe it even reverses course? It would be helpful to get a sense as to the backdrop that you are making assumptions on.

Then second, just while it is in the headlines, could you opine a little bit on what you think the import of Google doing an MVNO in this space is? Did you have a chance to talk to them about what their plans are as they were going in the market looking to try to execute on something? That would be helpful to get some color on that.

Great, thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Look, I think it’s important just to set the stage here. All the hype around 2014 around price competition and the intensity of the competition and just look at what Verizon delivered during all that period of time.

We had top-line growth of 5.7%. We expanded the EBITDA by $1 billion in Wireless. We expanded the EBITDA in Wireline of $200 million. We had net phone adds, which seems to the big issue, of 1.3 million in this competitive environment and we grew our overall net adds year-over-year by 24%.

So I think the basic point here is that we will continue to compete and we will continue to compete at a positive, profitable value. Also, it is important as we enter into 2015 with the competition we are also doing a lot of different things.

So number one, based on our base, as I said in my comments, we still have 13 million 3G smartphones and 18.5 million basic phones that we will pursue to upgrade into our 4G LTE network that is more efficient, generates more revenue. Tablets are only 8% of our base and, as I said in the past, tablets will continue to be a very large piece of our growth into the future.
Tablets are very, very good because, one, they make it more sticky at the account level. Two, we get a recurring revenue stream, albeit lower than a smartphone, but the subsidy on that is much reduced. And then also it also increases the amount of usage and video uptake on the network, which is what we are driving to as the more usage to benefit on the bundles.

The other thing is, as you look out to us and directions we are taking, obviously as we stated, Internet of Things is going to be a very important category. $585 million, up 45% year-over-year. And we don't really disclose it, but we have over 15 million connections now with Internet of Things.

We announced the Verizon Vehicle, as I said. You should look at us as launching over-the-top mobile-first sometime this summer, as Lowell has talked about in the past.

And on the Wireline side, we just launched a new router which we think is going to improve both the intake of video into the home, but it's also very important because it has to sustain the ability of wireless products within that home. And as you know, when you get four to five devices running on that router today that can only deliver up to 75 megabits, you are really not getting 75 megabits. So this router will be able to produce significant higher throughput and we believe it's the fastest in the industry today.

Putting that all in context from a competitive standpoint and what we can deliver, the guidance we are giving you is based on all the strategic actions that we will be taking in the future. The other two things I would talk about is, if you look at our prepaid base, again another positive quarter, up 7.5% on ARPU growth. And then, of course, our own reseller base with our own strategic initiatives with that, whether you call it a reseller base or MVNO, is all positive and growing positively.

So that leads me into the Google discussion. I guess what I would say right off the bat, number one, is this is just another very prime example of the intensity and the competition around this industry, the availability of the open networks and access to the networks. And this is why -- another reason of why this industry does not need to be regulated.

I would also say on this one is, if you look at Google, they have entered the fiber. They've done other initiatives. Their whole purpose is to increase speeds so that people can do more search.

What I would say is we will have to wait to see how they execute on the MVNO, but listen, MVNOs or resellers or people leasing the network from carriers has been around for 15 years. It's a complex issue. You have to deal directly with the consumer; there is a whole infrastructure that is needed to do that.

So I think this is another example of where Google is going to enter the market under a platform basis to do what they want to do and it's just another competitor as we look at it. So I will leave it at that.

David Barden - BofA Merrill Lynch - Analyst

Thanks a lot, Fran.

Operator

John Hodulik, UBS.

John Hodulik - UBS - Analyst

Thanks. Good morning, guys. As you look at the results of the Wireless quarter, churn and the upgrade rate really sort of stand out as having spiked. Obviously, there's a couple of drivers there: I think the competition and the number of iPhones you guys had renewing this quarter.
So is there a way, Fran, to sort of delineate the two? As you look out to 2015, are these -- do you expect these numbers to remain elevated because of competition, or should we expect them to both trend back towards a more normalized level? Thanks.

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

Thanks, John. So I think this is we need to look at. As we said in the remarks, and follow the words carefully, is that we will pursue our base, we will pursue net adds, and we will pursue upgrades that are financially beneficial to the Company.

So what that means is at a 1.14% churn rate, you should take that as we did not go to places where we did not financially want to go to save a customer. And there’s going to be certain customers who leave us for price and we are just not going to compete with that because it doesn’t make financial sense for us to do that.

As far as why upgrades were so high, I think you have to go back a little bit and reflect on what we did in the past. So if you look at 2013, we made a lot of policy changes around upgrades. It pushed the upgrade view back into 2014, so in 2014 we took probably more upgrades than we generally would have taken because of those policy changes.

But as we came out of the third quarter, I said that we had about 3.2 million iPhones in our base that were coming out of contract, and that was a signal that we were going to aggressively go after those 3.2 million customers. And we did. We are very satisfied with the quality of the upgrades.

So if you look at it from that perspective in the remarks I made, look at it on a percentage basis, 78% of our upgrades are what we would call strategic quality upgrades. And that means a 3G to 4G, a basic to 4G, or our high-value type customer who delivers a lot of value to us and we appreciate their business and we want to keep them as a customer.

So that’s how you should view this, John. And I think that with the competition and some of the pricing that’s out there, you should think that we are going to have a higher churn rate because some customers we are just not going to financially keep.

**Operator**

Mike Rollins, Citi Investment Research.

**Mike Rollins** - Citi Investment Research - Analyst

Thanks for taking the questions. Just two.

First, if you look at the margin guidance that you are providing on a consolidated level and the aspirations to improve the Wireline margins, does that mean that Wireless margins are facing some headwinds just as you are processing the higher volume environment coming off the fourth quarter and some of your initiatives that you’re planning for 2015?

Then secondly, Fran, if you can give us an update on your video strategy. Are there any more details or perspectives you could share with us on what that product might look like later in the year when you talked about launching it? Thanks.

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

Thanks, Michael. So on the competitive consolidated margin, look, I think it’s important again that you focus on the words.
We said at least top line 4% growth. We said that we would have at least a consolidated margin consistent with 2014. But I think you need to put it in perspective that we had an extremely heavy fourth quarter in 2014, so I would not expect that to repeat in 2015 given the iconic devices that hit and given the level of competition at this point in time versus what we would expect next year.

I think the other important thing, too, is as you are focusing in on this, I think it’s important to focus on 2014 earnings per share. So we grew at 18%. I know most of you will subtract out the 10% for the accretion of Vodafone, so when you look at it, the core business in this highly competitive environment grew at 8%.

I would also say that don’t get ahead of yourselves on the Wireline accretion of margin. As Lowell and I said before, this will be a slow progression of Wireline accretion. We grew 80 basis points this year. We will continue to focus in on top-line growth and continue to take out those costs, continue our copper to fiber migration efforts, and continue to become more efficient of a company.

So I wouldn’t read too much into we expect Wireline to jump off the charts and Wireless to go down.

On the over-the-top strategy, I guess I’m not going to disclose as to too much what we are going to do, but I think if you look at the environment there’s a lot of positive things coming out of the environment. So if you look at what Dish has done around some of their recent launches, look at CBS and their own launch of over-the-top with their own programming, this just leads us to a path of content owners are willing to open up their content to different models. And that is exactly what we’re going to execute on.

We are working with many content providers to join that model and we will have a lot more to say about that. And Marni and obviously Lowell will talk more about that when we launch our first product come this summer.

Mike Rollins - Citi Investment Research - Analyst

Thanks very much.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - Goldman Sachs - Analyst

Thanks. I’m going to follow up a little bit on what Mike said and, Fran, your response.

Typically when we see telecom operators start ramping content-driven models, there is a big upfront investment, particularly in content costs. So I was just wondering if you could maybe just help us think are we going to begin to see any of that spending flow through your P&L this year. And is that a component of how you thought about your margin guidance that you provided? Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Number one, under the traditional model of FIOS, obviously in our guidance we’ve included an increase in content cost because every year you have a content cost and you should feature in around -- consistent with where we were in 2014, around a 3% to 4% content increase cost right now is what we are projecting.

As far as the new model, again I’m not going to get a lot into that model. You should not think about it as a traditional linear TV model. It’s going to be, I would think, a different type of the model. So we will wait till mid-summer and we can talk more about that, but within our plan we do have those content costs.
Brett Feldman - Goldman Sachs - Analyst

Great, thanks for the color.

Operator

Mike McCormack, Jefferies.

Mike McCormack - Jefferies & Company - Analyst

Thanks. I guess, Fran, following on, and it's I guess somewhat related to the Wireless margin story in 2015, but just trying to get a sense for what your thoughts are on ARPA sort of puts and takes. Obviously you are talking about some potential I guess save retention tools on your base; the competitive landscape. Do we still think you can get some modest growth on ARPA in 2015?

Then, secondly, the CapEx level I think is a bit above what prior commentary had been. Not dramatically, but I'm trying to get a sense for what that is, whether it's Wireline, Wireless. I know you and I had spoken about densification back in December; I am assuming it's probably related to that. Thanks.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Thanks, Mike. So on the VZW margin, the follow-up question around the ARPA, I think this becomes a more tricky question because obviously ARPA is around service, and with the Edge program we are kind of convoluting that now. That it's a tougher metric to get your hands around, which is why we are giving out the recurring installment billings to try to get it on an apples-to-apples comparison. But if you think about that, we grew that ARPA by 5.2%.

So, look, I think given everything that's going on and given the fact that I said we would have a top-line growth of 4%, obviously we believe that we can continue to accrete the ARPA of this business given everything I said about the additional growth things that we are keying in on. Just the jump-off point that we came into this year.

So the other thing, too, is if you go back to 2012, the fourth quarter of 2012 was very much like this quarter of 2014. We really placed a bet on growth and upgrades and solidifying our base in 2012, albeit we added a lot more smartphone net adds back then, but it's pretty much the same quarter that gives us a great basis to jump off into 2015. So that's how I would think about the ARPA metric.

On CapEx, Mike, it goes directly to what you said. I have been pretty consistent with this in the fact that we will spend more CapEx in the Wireless side and we will continue to curtail CapEx on the Wireline side. Some of that is because we are getting to the end of our committed build around FIOS, penetration is getting higher.

We are reconnecting homes that we've already connected, so it's not additional capital that we have to outlay and we are very focused on those, what we call connected homes, that are not our customers to go back after them. That is a very good return for us because we already spent the capital to connect that home.

So it's a lot of combination around that, but yes, this is around densification. This is around our projection of growth for the wireless industry and staying ahead of that. Again, it's all that encompassing so we're looking at a slight increase from where we ended 2014.
Mike McCormack - Jefferies & Company - Analyst

Fran, just thinking about the densification, are there particular markets where you guys are spending more? Are there pressure points that you look at in 2015 as being areas where you just sort of not rush and got out and spend, but areas of focus?

Fran Shammo - Verizon Communications Inc. - EVP & CFO

No, not really. It’s pretty consistent with what we did in 2014. Obviously, your major cities are where you have your biggest densification happening right now. Because as we launch AWS around the US and get the coverage map up, AWS is really handling most of that outside of the major cities. But it’s the major cities that are being densified on a quicker basis.

Mike McCormack - Jefferies & Company - Analyst

Okay, great. Thank you, guys.

Operator

Amir Rozwadowski, Barclays.

Amir Rozwadowski - Barclays Capital - Analyst

Thank you very much and good morning, folks. Fran, it does seem as though one of the standouts for you folks has been the ability to reduce costs through operational efficiency. And I know you touched upon this with some of the questions and your prepared remarks.

But is there any sense that you can give us the scope of opportunities over a multiyear period? I guess the genesis of the question is really we find ourselves in an intensely competitive environment, as you’ve mentioned. How much opportunity is there for you folks to continue to drive down costs in order to retain this sort of industry-leading margin profile and cash generation ability that you guys have delivered for the last couple of years?

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Just a couple of thoughts around that. Number one is obviously the more and more we convert 3G customers to 4G that affords us the ability to get on a much more efficient network. It affords us the ability to re-appropriate our spectrum and it affords us to actually start to run down, if you will, the higher-cost network of 3G. So all of that plays into this.

The other thing is, as we said before, we have a very high cost structure in servicing our customers and you are going to see some things different of how we approach customers. Mainly around getting more around self-serve, so that we can do more off the handsets. And we saw over the last two years starting in 2013 into 2014 that this played a big role in how we take costs out of the Wireless cost structure.

On the Wireline side, it’s just continuing to do more of the same. So we really don’t play up the fact of all the copper-to-fiber migration, but this is really starting to pay benefits to us.

And as we’ve said, we’ve been doing this for the last three years. We are now in the position of starting to shut down central offices, which free up real estate for us to monetize and get out of. It reduces the property tax around this, so there’s a lot of efficiencies that come from this.
The other thing is that within the one-time charges you probably picked up a severance accrual. In December the Wireline company already has reduced about 2,300 headcount, including about 1,300 represented workforce who took an additional incentive for them to voluntary retire. We are setting the Company up once again to produce a very beneficial, efficient cost structure going into 2015.

Amir Rozwadowski - Barclays Capital - Analyst
Thank you very much.

Kevin Smithen - Macquarie Research Equities - Analyst
Thanks, I wanted to follow-up on your comments about not chasing unprofitable subs and upgrades. Does that change if you begin to go negative on phone net adds? Like, what is your tolerance for sub losses? Because in the past that has been a key level where you've responded with some retention and offensive marketing.

Fran Shammo - Verizon Communications Inc. - EVP & CFO
Kevin, we always have save programs and specific targeting to a specific customer base or a specific segment, so that's not going to change. My point is here is that there are certain customers that will go for the lowest price and at that point we are probably not going to compete on price with those customers. And that is what you saw.

If you look at it for the fourth quarter, we added 672,000 net phone adds. So I think you have to keep it all in focus that what we are gaining -- we are gaining 4G high-value customers and we are not necessarily losing that 4G high-value customer. So I think you have to look at it in a holistic point of view, but that's really the strategy that we have deployed and we will continue to execute on that strategy.

Kevin Smithen - Macquarie Research Equities - Analyst
Just a quick follow-up. Does your guidance change at all under certain Title II outcomes? And what is your current thinking on this, given recent government comments?

Fran Shammo - Verizon Communications Inc. - EVP & CFO
That's a great question, because I personally have been misquoted both in the press and in Congress on what I've said. So this is a good question for me to clear this up.

First of all, this is not an issue about Internet rules. It's about an issue of FCC reclassifying broadband as a Title II service, and this will absolutely affect us and the industry on long-term investment in our networks.

That can be seen factually as to what happened in the rest of the world, where you have high regulation, the networks are not invested in, they are not good quality of service networks. And that's where this will put us.
I guess I would emphasize also that the approach, in whole or in part, on Title II is an extreme and risky path that will jeopardize our investment and the development of innovation in broadband Internet and related services. It will also tie up the industry in a very uncertain time and cause all types of litigation.

So when I said before and misquoted on the fact that it would not hurt our investment, I was talking about 2015. But if this piece of Title II was to pass, I can absolutely assure you it would certainly change the way we then view our investment in our networks.

The other thing, too, is I think it is important to show that this industry, on a high-level basis, has invested about $50 billion a year in networks and improving the quality of service and open network to everyone. That is what the industry believes is that this is an open Internet basis.

If we curtail the investment of this industry, it will definitely trickle down to what we would consider middle-class jobs. And it’s because of most of -- at least for Verizon Wireless, a lot of our build are done by thousands of contractors across the United States. That will impact those small businesses and impact their employees.

So from that perspective, I guess what we would say, Kevin, is we would encourage Congress to adopt a legislative solution. Congress has the authority to adopt clear rules of the road that will allow policymakers in the industry to move on to more important things. So I think that summarizes the position about Title II.

Kevin Smithen - Macquarie Research Equities - Analyst

Very helpful, thank you.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - Wells Fargo Securities - Analyst

Great. Thanks, Fran. Just two quick questions, if I may. Just an update on thoughts around the tower sale. I assume it’s still part of the plan.

Secondly, I just wanted to explore the ARPU question. A lot was made of your November 1 price cut, but am I crazy to think you could look at this glass half-full? Because with 84% of your traffic now on LTE, and I think you said 66% of your base on LTE phones, did you see some movement upward with that price change that actually could have offset any sort of downward movement you saw? Thanks a lot.

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Thanks, Jennifer. On the tower sales, look, I think we’ve been pretty clear on the remarks here. We are not going to talk about the rumors anymore until there’s something to substantially state. So at this point I think we will just leave it at that.

As far as the price cuts, you are absolutely correct, Jennifer; when we look at the provisioning of our base, we have seen a significant increase in the amount of customers who are taking our higher data plans, if you will, that drive more revenue. And even with those higher plans, we still see a large portion of those customers breaking their bundles because of video consumption and the increase in video consumption.

So, yes, there is an offset here. It is not all just dilution; there is an upgrade of what customers are using. And obviously we’ve built the plans around LTE. We’ve built the plans around we want customers to use more because that’s what will generate incremental revenue for the business and give us a return on the continued investment in our network.
Jennifer Fritzsche - Wells Fargo Securities - Analyst

Great, thank you.

Michael Stefanski - Verizon Communications Inc. - SVP, IR

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

Fran Shammo - Verizon Communications Inc. - EVP & CFO

Thanks, Mike. So at conclusion here I just want to state that Verizon had another strong year of operating and financial results with top-line revenue growth and quality earnings and cash generation. We are very focused on driving growth and profitability.

To that end, our execution strategy is around the assets we have in place. As always, we continually look at options for monetizing certain less-strategic assets and creating value for our shareholders. We continue to develop new products and services in the area of video delivery, Internet of Things that will drive growth and profitability into 2015 and beyond.

We look forward to a very positive 2015 with confidence in our ability to execute our strategy, grow the business profitably, and invest for our future. Thank you all for joining today and 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.