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VZ - Q2 2015 Verizon Communications Inc Earnings Call

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Overview:
Co. reported 1H15 EPS of $2.06. 2Q15 total operating revenues were $32.2b and GAAP reported EPS was $1.04. Expects full-year 2015 consolidated revenue growth to be at least 3% and 3Q15 consolidated revenue growth to be higher than 2Q15.
Good morning and welcome to the Verizon second-quarter 2015 earnings conference call. (Operator Instructions) Today’s conference is being recorded. If you have any objections, you may disconnect at this time.

It is now my pleasure to turn the call over to your host, Mr. Michael Stefanski, Senior Vice President, Investor Relations.

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

Thanks, Marley. Good morning and welcome to our second-quarter 2015 earnings conference call. This is Mike Stefanski and I’m here with our Chief Financial Officer, Fran Shammo. Thank you for joining us this morning.

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

Before we get started I would like to draw your attention to our Safe Harbor statement on slide 2. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. Discussion of factors that may affect future results is contained in 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. The quarterly growth rates disclosed in our presentation slides and during our formal remarks are on a year-over-year basis, unless otherwise noted as sequential.

Before Fran goes through our results I would like to highlight a few items. GAAP reported earnings for the quarter were $1.04 per share compared to $1.01 per share in the second quarter of last year. There were no special items of a nonoperational nature in the second quarter of this year.
The second quarter of last year included $0.10 per share from a gain on the sale of spectrum. So on an adjusted basis EPS growth was 14.3%. Adjusted EBITDA growth for the quarter, excluding this prior-year gain, was 6%.

Through the first half of the year, earnings totaled $2.06 per share compared with adjusted earnings of $1.76 per share last year. However, as we have consistently pointed out, last year's adjusted EPS would've been about $0.07 higher on a non-GAAP illustrative basis if we assumed 100% Wireless ownership for the entire first quarter. On this more comparable basis the adjusted EPS growth rate for the first half of this year was 12.6%.

Beginning this quarter we are reporting Wireless equipment revenue and Wireless cost of equipment in our consolidated statements of income. In our Wireless segment we are reporting the cost of equipment and the cost of service, which were previously combined as cost of service and sales. Prior-period detail at both the consolidated and Wireless segment level is included in the financial and operating information schedules on our website.

I would also remind you that our Wireline results include the operations that we agreed to sell to Frontier. This will be the case until the transaction closes, which is on track for the first half of 2016. As we pointed out last quarter, the assets and liabilities associated with these operations have been classified on the balance sheet as held-for-sale and, as such, we are no longer recording depreciation expense. For the full year we continue to estimate the earnings benefit to be about $0.12 to $0.13 per share.

The acquisition of AOL, which we announced in mid-May, closed on June 23. Our balance sheet at June 30 includes the AOL assets and liabilities. Our income statement for the second quarter does not reflect any results of AOL operations for the last seven days of the month due to immateriality. The AOL results of operations will be fully included in the third quarter.

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

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

Thanks, Mike. Good morning, everyone. Our second-quarter results demonstrate that we continue to compete effectively and execute our strategy, which is focused on providing consistent network reliability and a great customer experience. Once again, we delivered strong financial and operating results with double-digit growth in earnings and strong cash flows.

We believe that steady and consistent network and platform investment provides the foundation for innovative products and services for future profitable growth. We are committed to building the business for the future through a disciplined capital allocation model that we outlined almost two years ago and continue to execute.

Through the first half of this year, we have invested approximately $18 billion in spectrum licenses and capital for future network capacity. We also invested more than $4 billion to acquire new capabilities with the AOL transaction, which supports our long-term video strategy.

In addition, we returned more than $9 billion to our shareholders in the form of dividends and share repurchases. The $5 billion accelerated share repurchase program was completed in early June, resulting in an overall reduction of 101.6 million shares.

We facilitated these initiatives while keeping our leverage ratio essentially unchanged and remaining on track with our deleverage plan. On the execution front, we had a strong quarter of quality connections growth and profitability in Wireless. We had more than 1.1 million retail postpaid net adds, which included 321,000 net phone additions.

We also had very strong customer retention, with postpaid churn of 0.90%, down 4 basis points year over year. This was our lowest churn rate in three years.

Total Wireless revenue grew 5.3% and EBITDA increased by 9.1%. Our EBITDA margin on both service and total Wireless revenue expanded on a year-over-year basis. Our Wireline results were once again highlighted by growth in the consumer market, where revenues were up over 4%. Our segment EBITDA margin expanded modestly on a sequential and year-over-year basis.
Now let’s get into our second-quarter performance in more detail, starting with our consolidated results on slide 4.

Total operating revenue was $32.2 billion in the quarter, and if we exclude the prior-period revenues from the public sector business we sold last year, the comparable growth rate would have been 2.8%. Consolidated top-line revenue growth continued to be driven by Wireless and FiOS usage. We believe that future revenue growth will come from video and the Internet of Things at both the network and platform layers.

Over the past several years, we have been investing in these platforms and positioning ourselves to capitalize on these new sources of growth.

In terms of video, we will introduce our mobile-first OTT video product in late summer. As you know, we have already announced some initial content partners. Our acquisition of AOL further enhances our video strategy through its digital media and advertising platform capabilities, a portfolio of content brands with a domestic average of about 190 million unique visitors per month and its loyal email subscription customer base. We are excited to have the very talented people of AOL on the Verizon team and look forward to their contributions to our success.

As far as Internet of Things, we think that the transportation, healthcare, and energy industries in particular present great opportunities for us and we are very active fostering innovation in these areas. We are very well-positioned to capitalize on these new growth opportunities and we will continue to develop business models to monetize usage on our network and at the platform level.

Within our current results, new revenue streams from the Internet of Things and telematics continue to emerge and grow. These revenues totaled approximately $165 million in the quarter and about $320 million year-to-date. We continue to be focused on reducing our overall cost structure through process improvements and operating efficiencies, while improving the overall customer experience. Consolidated EBITDA totaled $11.8 billion, up 6% on an adjusted basis, and our EBITDA margin expanded by 110 basis points to 36.6%.

Let’s turn now to cash flows and the balance sheet on slide 5.

As highlighted a few minutes ago, our capital allocation model is disciplined and consistent. The priorities are to invest necessary capital in our networks to stay ahead of demand, return value to shareholders, and maintain a strong balance sheet. The cash flows we generate enable us to execute on this investment strategy, pay competitive dividends, and deleverage to further strengthen the balance sheet.

In the second quarter, cash flows from operations were $8.7 billion. Through the first half, cash flow from operations totaled $18.9 billion, but included just under $2.4 billion of proceeds related to the tower monetization transaction, which is nonrecurring. We also continue to securitize Wireless equipment installment receivables and received about $1.2 billion in cash proceeds in the second quarter. Free cash flow for the first half of the year, excluding the tower proceeds, totaled $8.4 billion.

Capital expenditures were $4.5 billion in the quarter and $8.2 billion for the first half of the year. We expect capital expenditures for 2015 to be within our stated range of $17.5 billion to $18 billion.

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 quarter with $113.7 billion of gross debt, net debt of $110.7 billion, and a ratio of net debt to adjusted EBITDA of 2.5 times. As I said earlier, our deleveraging plans remain on track.

Now, let’s move into a review of the segments, starting with Wireless on slide 6.

In the Wireless business, revenue growth, profitability, and cash flows are driven by our high-quality retail postpaid customer base. As I said earlier, total Wireless operating revenues grew 5.3% in the quarter to $22.6 billion. Service revenue of $17.7 billion declined 2.2%, while equipment revenue increased to $3.9 billion, up nearly 62%. Service revenue plus installment billings increased 2.3%.

For customers who select device installment plans, lower service pricing is exchanged for higher device payments. Equipment revenue, which is largely recognized upfront, is much higher than in the subsidy model. Service revenue growth will continue to be pressured as more customers choose unsubsidized devices and equipment revenues will continue to increase with installment plan adoption.
Customer demand for device installment plans has increased. The percentage of phone activations on installments grew to 49% in the quarter compared with 39% in the first quarter and only 18% a year ago. Phone activations on device installment plans totaled 4.7 million in the quarter and we now have more than 14 million customers on these plans, representing roughly 16% of our postpaid phone base.

Looking ahead, we believe that the percentage of phone activations on installment will continue to increase and will likely be around 60% in the third quarter.

In terms of profitability, we generated $9.9 billion of EBITDA in the quarter, an increase of 9.1%. Our EBITDA service margin increased to 56.1%, up 580 basis points. The EBITDA margin on total Wireless revenue expanded to 43.9% in the quarter, up from 42.3% a year ago.

Now let’s turn to slide 7 and take a closer look at Wireless connections growth.

We ended the quarter with 109.5 million total retail connections. This does not include any wholesale or Internet of Things connections. Our industry-leading postpaid connections base grew 5.2% to 103.7 million and our prepaid connections totaled 5.8 million.

Postpaid gross additions improved sequentially to 3.9 million, but were down year over year, due primarily to lower tablet volumes. As I highlighted earlier, we had a very strong customer retention in the quarter with postpaid churn improving both sequentially and year over year to 0.90%. One of our priorities this year was to improve customer retention and we are doing so with a disciplined approach, focusing on high-value customers.

Our retail postpaid net additions of more than 1.1 million were nearly twice the net additions in the first quarter. The quality of the net adds remained very strong with 842,000 new 4G smartphones in the quarter. Postpaid phone additions totaled 321,000 as net phone adds of 588,000 were partially offset by a net decline of 266,000 basic phones. Tablet net adds totaled 852,000 in the quarter and net prepaid devices declined by 126,000.

Let’s now take a look at 4G device activations and upgrades on slide 8. Total postpaid device activations totaled 11.3 million in the quarter, up nearly 2%. About 85% of these activations were phones and the rest were mainly tablets. We ended the quarter with 70.1 million smartphones in total and our smartphone penetration increased to approximately 81% of total phones.

4G devices now comprise approximately 73% of our retail postpaid connections base. As you would expect, growth in 4G device adoption continues to drive increased data and video usage. Approximately 87% of our total data traffic is on the LTE network and overall traffic on LTE has essentially doubled in the past year.

About 7.2% of our retail postpaid base upgraded to a new device in the second quarter. The quality of our phone base continues to improve as we add new 4G customers and upgrade our basic phone and 3G smartphone customers to 4G devices as part of our retention efforts.

In the past year, our 4G smartphone connections have increased by 17.8 million, or about 40%, to 61.6 million. We still have a sizable opportunity remaining with roughly 16 million basic phones and about 9 million 3G smartphones in our postpaid connections base.

We also have a profitable growth opportunity with tablets as they provide good value through increased data consumption and lower churn rate at the account level. We ended the quarter with 9.6 million tablets in our postpaid connection base, so overall penetration is still under 10%.

In terms of capital spending, we continue investing for the capacity to further optimize our 4G LTE network and position the network for the future. Wireless capital spending totaled $3.1 billion in the quarter and $5.5 billion for the first half of the year, about 4% higher on a year-to-date basis. National studies consistently rate Verizon as the overall 4G LTE network performance leader. We lead in what matters most to customers, coverage and consistent, reliable performance.

Currently our 700MHz and AWS-1 spectrum bands, which represent about 40% of our licensed spectrum portfolio, are utilized in our LTE network. We are just beginning to re-farm 1900MHz PCS spectrum from 3G to 4G LTE in select markets, representing the next phase of spectrum to be deployed to serve our growing LTE usage.
Our network densification plans, which include small cells, DAS nodes, and in-building solutions, are on schedule. In New York City we are well into our deployment and continue to scale and develop a healthy pipeline. Downtown Chicago is another large urban market with small cell densification plans well underway, consistent with what we outlined on our post-auction conference call.

Let's move next to our Wireline segment, starting with a review of our consumer and mass markets revenue performance on slide 9.

In the consumer business, FiOS continues to be the driver of our positive revenue trends, resulting in revenue growth of 4.5%. Mass markets, which includes small business, grew 3.2%. FiOS now represents 79% of consumer revenue. In the second quarter, FiOS consumer revenue grew 9.8%, driven by customer growth, increased penetration of our Quantum products, and higher pay-per-view sales due to the prizefight in early May.

Our FiOS Quantum broadband service continues to scale and with a higher profitability contribution. At the end of the quarter, 64% of our consumer FiOS Internet customers subscribe to data speeds of 50 megabits per second or higher. We are seeing the highest rate of growth in the 75 megabit speed tier, where 23% of our consumer FiOS customers currently subscribe.

In broadband, we added 72,000 net FiOS customers and now have a total of 6.8 million FiOS Internet subscribers, which is 41.4% penetration. Overall, net broadband subscribers decreased by 25,000 in the quarter. In FiOS video, we added 26,000 net customers in the quarter and now have a total of 5.8 million FiOS video subscribers, which represents 35.7% penetration.

We have strong customer interest in our Custom TV offering. More than one-third of our FiOS video gross adds this quarter opted for a Custom TV package and we also saw migration demand from existing customers. We will continue to work with content providers on this new product, which so far is ahead of our expectations. While adoption of Custom TV may initially have a negative impact on revenue growth, it should improve profitability.

In the second quarter, we experienced a slowing of FiOS customer growth, which we attribute to triple play offer changes at a time of increased competitive intensity. We have since made some promotional adjustments and our exit rate sales volumes have shown improvement.

We are focused on the continued evolution of our Wireline network. In the second quarter, we converted 51,000 copper customers, bringing our first-half total to 98,000. As I have previously noted, post conversion we experienced significant improvements in customer satisfaction and a lower cost to serve.

Our agreement with Frontier for the sale of Wireline assets in the noncontiguous states of Florida, Texas, and California is also part of our network evolution, as it will enable us to better focus our efforts on the highly dense markets in the Northeast. We are working closely with Frontier to obtain the necessary regulatory approvals and assure a seamless transition. We are making progress and remain on track to close the transaction in the first half of 2016.

Let's turn to slide 10 and cover enterprise and wholesale as well as the Wireline segment in total.

In the enterprise space, we continue to work through secular and economic challenges. In the second quarter, global enterprise revenue declined 6.4%. Excluding foreign-exchange pressure, the revenue decline was similar to the first quarter. Declines in legacy transport revenue and CPE continue to outweigh growth in the newer and more strategic applications which are smaller in scale. Revenue from services in the IP layer has been impacted by the competitive price compression, which is offsetting growth in applications.

In our global wholesale business, revenues declined 4.5% in the second quarter, which was better than expected due to some nonrecurring items. We expect continued price compression, technology migration, and other secular challenges to pressure wholesale revenues, which we expect to decline in the 5% to 6% range for the full year.

Total operating revenues for the entire Wireline segment were down 2.2%, which included some FX pressure. The segment EBITDA margin was 23.5% in the quarter, up 10 basis points. We are very committed to reducing our cost structure while maintaining strong customer satisfaction.
The Wireline headcount was down 10% year over year and we continue to strive for gains in operational efficiency. As I have said, we are far from satisfied and we will continue to work on our cost structure.

Capital spending in Wireline for the first half of the year totaled $2.2 billion, down 19%.

Let’s move next to our summary slide. We have had a good first half of 2015, delivering strong financial and operating results with double-digit growth in earnings and strong cash flows. As always, we continue to invest in our networks and platforms to position us for future growth.

We are very focused on developing new products and services in mobile video and the Internet of Things. We are excited about the potential for revenues from these new products and services to grow quickly and become more meaningful in the future. Our acquisition of AOL will be a key piece in our over-the-top mobile video strategy, accelerating our capabilities in digital media and advertising.

We are confident in our ability to sustain profitability. Consolidated EBITDA for the first half of the year was up nearly 6% on an adjusted basis and our EBITDA margin expanded 90 basis points to 37%. In terms of consolidated revenue outlook, we expect third-quarter revenue growth to be higher than this quarter.

For the full year, our consolidated revenue guidance is for growth of at least 3%. These growth estimates exclude revenue from AOL, which will become part of our results in the third quarter. We continue to target overall capital spending in the range of $17.5 billion to $18 billion in 2015.

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. Marley, we’re now ready for questions.

QUESTIONS AND ANSWERS

Operator

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

David Barden - BofA Merrill Lynch - Analyst

Thanks for taking the questions. I guess two, if I could. Fran, could you kind of give us a little bit more color on the change in the revenue guidance for the year? Obviously what’s different between when you were expecting 4% versus 3%? Then obviously what the moving parts are to get accelerated revenue growth in the second half?

Then I think the second question would be, for the markets reacting to something today, I think it’s the sequential movement in the ARPA or the ARPU. Obviously there’s lots of moving parts in there. There’s the impact of EIP. There is the impact of mix change.

But I think the market is also trying to see through those and figure out what the net movement is in terms of people pricing themselves up in the buckets and generating more ARPU versus some of the givebacks and the competitive pressure we are seeing inside the system at Verizon. If you could give us more color on how the net is moving on pricing inside the base, that would be helpful. Thanks.
Fran Shammo - Verizon Communications, Inc. - EVP & CFO

Sure, good. Thanks, David. First on the revenue guidance; look, coming into this year we set a priority that we said we would protect our base. And I think if you look at the results of the first quarter and the second quarter, the churn speaks for itself with 4 basis points improvement from the first quarter year over year and then the second quarter year over year, with the 0.90% being the lowest churn rate in the last three years that we have posted up.

In addition, some of the other changes in the assumption fact is the take rate of Edge. I would tell you we never anticipated that Edge would accelerate as much as it has, and looking forward into 3Q being at 60%, that’s much higher than we had anticipated. But the market has moved us there.

And, quite honestly, it’s getting more and more confusing at the frontline and this really translates into simplicity for our customers in choosing the Edge plan. And that is where the market has gone, so that’s where we need to compete.

And then finally, from an upgrade perspective, going back to protection of our base, we’re up 800,000 upgrades year over year. So more people are selecting the new price plans when they get a new handset and that puts us on the Edge, which obviously generates more equipment revenue and puts pressure on the service revenue. Coming into this year we knew that service revenue would dilute. We are seeing more dilution than we anticipated because more customers are selecting that Edge plan.

But I think just a couple things to keep in check here, because when you zero in on one metric you are walking away with the wrong impression as to what’s happening to the overall P&L.

So, first off, we generated growth in revenue of 5.3% in Wireless this quarter. If you look at the first half of the year, that’s $2.5 billion of revenue growth just in the first half. You annualize that, that’s growth that is bigger than some Fortune 500 companies generate in the full year of revenues.

So this is still a very healthy business and it goes to what the overall industry is as well. So there’s a lot going on in the industry to generate more usage in the future.

If you look at the IARPA, which is the installment plus the revenue per account, we are up 2.3%. So if you just focus in on the service revenue, of course that’s going to dilute year over year, but I think you have to step up and look at the overall financials of Verizon Wireless. In addition, if you look at the connections, we are up 4.3% year over year in connections and we’re also up in accounts.

So when you look out to the future you are adding accounts; you are adding devices. That is also going to be more usage on the network. And, obviously, the whole future of the industry is based on generating more usage on the network so that people want to use more, and we know from a fact that more people are consuming more video in wireless today than there were a year ago. So that’s all part of the strategy.

You look at tablets; we’re so less than 10% of the base in penetration of tablets. That’s still another growth area for us.

Then you look at Internet of Things. Internet of Things is still in early stages for the entire industry. There’s more and more devices coming out that is going to generate revenue in the future.

And then, of course, if you just look at Verizon, we have the whole AOL and OTT launch, which we will get to. We just launched Custom TV in Wireline and that in itself will also put pressure on the top line. So if you think about the Custom TV package, customers are now only paying for what they want to view and we are only paying the content providers for what our customers want to view.

So what you are seeing is you are seeing a decrease in revenue, but you are also seeing a decrease in content costs that actually improves the profitability. So if you look back and you look at the entire portfolio of what’s going on, I think you walk away with a very different conclusion than if you just look at the ARPU, because we know that ARPU is going to get condensed with the new EIP plan.

So thanks, David, for the question.
Simon Flannery - Morgan Stanley - Analyst

Thanks. Good morning, Fran, you talked a bit about productivity and cost initiatives earlier. Can you just update us on the steps you are taking to offset the dilution from the divestiture to Frontier next year? And perhaps in the context of that you can just update us on the union negotiations. I guess that deadline is coming up here shortly. Thanks.

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

Sure. Thanks, Simon. On productivity and cost, look, we've been active now for three years and our VLSS program, Verizon Lean Six Sigma program, continues to generate savings. If you just look at Wireline, year over year down almost 8,000 employees from a year-over-year basis and still generating the great customer service and the volumes that we have there. So that speaks to the efficiency that we are getting both in the network efficiency side, reduction of over time.

And of course, as the industry matures now, you are looking at a lot of houses that already have an ONT on the side of the house so it's less labor because you're just activating the house that now doesn't really need much of a truck rolled to go to it. So there's a lot of efficiencies there. In the Wireless side a lot of concentration on self-serve and customer service centers. And then we go to structure around the Wireless unit. We are still on that whole productivity cost routine and we still believe that we have a very full runway in front of us, and you're going to continue to see us take costs out of this structure. If you just look at year over year on cash costs alone, if you look at our revenue growth versus cash costs, we're really maintaining cash costs at a very slow incremental increase. So that speaks to the efficiency that we are driving through all of our initiatives.

On the Frontier side, we still have -- we are expecting to close this transaction towards the end of the first quarter, so we still have about eight to nine months of planning activity. We are well on our way and I think what we have done in the past speaks for itself as how we will address this in the future.

Obviously, I will talk more about this as we get closer, but we are still designing those plans. Obviously you know Dan Mead is leading that team and he is very diligent in what he is doing to prepare us for the separation of that unit and getting our costs within alignment to offset the stranded cost perspective.

On the union side of the house, just as we know there are, in total, 27 collective bargaining agreements covering about 38,000 people in nine Eastern states. We began formal negotiations on June 22 and to jumpstart the negotiations the Company put forth a comprehensive offer on the table, which included wage increases and changes to current contracts, to help us manage our costs and increase our flexibility to better serve our customers.

Simply stated, we will need to modernize our legacy contracts to better position us to compete in the digital age. Given the level of change we are seeking with respect to benefit cost management, as well as work roles, our expectation is that the negotiation process will take some time. As you know, it is not unusual for negotiations to continue well beyond the expiration date of the contract, which is August 1.
We intend to work through the process until we achieve a new agreement that addresses the needs of our business and preserves the high quality of our jobs for our employees. So I think, as far as that goes, that is probably all I'm going to say around the union negotiations. It is early on and we still have a lot of work to do.

Simon Flannery - Morgan Stanley - Analyst

All right, thank you.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst

Thanks, guys. I guess, Fran, if you could start on expanding on Custom TV. Any update on discussions with programmers there? Are people sort of -- it seems like people are taking smaller packages than they would have otherwise. What is the average number of add-ons and any particular favorites that people are either walking away from or going to?

Then, second, just a housekeeping issue. I wonder if you can detail for us the impact of AOL on the P&L. Just sort of rough numbers on the different areas and how you're going to report that going forward, thanks.

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

On Custom TV, obviously we know we were paving the path to a new venture here to give customers what they wanted. Obviously I'm not going to comment on any litigation matters currently in effect with Disney and ESPN, as everyone knows that we are being sued on the contractual arrangement there. I am really not going to talk about that.

But, look, we continue to have a great partnership with Disney and ESPN and we will continue to work through that disagreement in our business relationships. And I will tell you, if you just look at the over-the-top product, ESPN is participating with college sports in that. So we will continue to work with ESPN and the lawsuit will take its own course of action. Again, we believe we are in our contractual rights to offer what we are offering.

From a customer selection perspective, I will tell you that this has certainly exceeded our expectations. As we saw through the quarter once we launched this, we saw the uptake rate increase. As I said in my prepared remarks, over a third of the customers now coming in are selecting a Custom TV package.

I will tell you that, as far as the number of genres that they take, it's less than what we anticipated, but they are selecting based on their own favorability. I'm not going to get into who selects what and how many we're doing there, but I will tell you that it is -- it will put pressure on the top line, but it obviously is going to improve our profitability here from a programming standpoint. So we will continue to work through that.

The other thing I wanted to mention just the growth metrics of FiOS here, as you know, given the disputes that we had in Custom TV, we also were blacked out from many content providers in advertising this product during the quarter. In two of the biggest markets, both New York and Philadelphia, we were unable to advertise the Custom TV package for approximately 45 days until we worked through that. So that also contributed to some of the slower growth in FiOS because it took us out of market for that period of time during the quarter.

Then, of course, in addition to that we had the Time Warner Cable separation of the merger, which both entrants came back into the market pretty competitively. So that puts some pressure on this as well. But even with that we saw some great progress with the Custom TV package.
On the second piece, Phil, with AOL, there is nothing included in AOL from a P&L perspective this quarter. We closed it at the end of the quarter. It was totally immaterial and from a cutoff perspective it just wasn't materially enough for us to include.

However, we did include the opening balance sheet. We've done a preliminary assessment on the fair value of the assets that we acquired. We had an independent third-party do that on a preliminary basis, and that is included in the balance sheet.

So you will see goodwill has increased for the acquisition as well as our customer list, because there was value assigned to the subscription business of AOL. But from a P&L standpoint, there was no revenue or expenses included this quarter. That will be included for the first time in the third quarter, and at this point we will be including that in our overall corporate results for the remainder of this year.

Then, as I said before, we will have to wait to see where we go with this, whether we include it as a separate viewable or we disclose revenues or how we're going to do that in the future. And I don't have an answer yet on that piece. We will wait till first quarter and entering into 2016 to give you more of a view into what happens going forward.

Phil Cusick - JPMorgan - Analyst

Thanks, Fran.

Operator

Brett Feldman, Goldman Sachs.

Brett Feldman - Goldman Sachs - Analyst

Thanks and thanks for the comments on the retention efforts. Just as a follow-up to that, you have seen your churn rate in postpaid decline year over year for two quarters now. Do you have conviction you're going to be able to see your churn rate sort of stay at a low run rate for the balance of the year in light of your focus on it?

And then just you noted that you are still planning on launching the mobile video service this summer. Are we going to see the full rollout this summer or is it going to be something that is going to be phased in over time? And just along those lines, where are you with the adoption or the penetration of your multicast devices? Thanks.

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

Sure. Thanks, Brett. First, on churn. We have made -- as I said coming into this year, we were really going to concentrate on protection of our base and I think we have shown that. If you just look at -- we don't really disclose this, but if you just look at our basic churn rate, we've seen even double what we've seen in the overall churn rate improvement.

We are maintaining those basic phone customers and converting them into a 4G LTE smartphone device and we're seeing really good progress on that. And that is part of the $80 price point that we have in the market. It has been very, very successful for us in the retention of our customer base.

But speaking on the churn piece, I just want to caution everybody, be careful because there is seasonality in the churn. Generally third quarter is a little bit higher than the second quarter, but we do believe that we will still be able to improve on a year-over-year basis.

As far as the over-the-top launch, we are absolutely going to be ready to go by late summer. It won't be the full entire of everything that we contemplate within the product set. It will be an initial launch and as the year goes on it will progress.
More to come on that, but as you know, we have signed up a number of content providers: sports channels, DreamWorks, AwesomenessTV, VICE Media, Scripps, and of course, we can’t leave out the AOL content that is coming with the acquisition, including Huff Post and TechCrunch. So we have a very good lineup.

This is a lineup that is really around all live-type news clips and sports and events, so very different than what anyone else is bringing to the marketplace. More to come on that this summer from Marni and Tim Armstrong and his team, who now owns this product set.

Then on the multicast, again as we go through this, all the phones that we sold in the fourth quarter have the capability of multicast other than the 6 and the 6+, and we continue to feed the market with those multicast devices. I can’t speak to exactly what the next iconic device will have in it, so we will have to wait to see what that comes out with. But this will continue to grow over the next year to have the proliferation of units in the marketplace to make this matter as we continue on with our OTT launch.

**Brett Feldman - Goldman Sachs - Analyst**

Great, thanks for the color.

**Operator**

Mike Rollins, Citigroup.

**Mike Rollins - Citigroup - Analyst**

Thanks and good morning. Two questions for me. Fran, first just a housekeeping item. I’m wondering if you could disclose the receivable amount for the equipment installment plan that you sold, both current and noncurrent, at the end of the second quarter.

And then, more strategically, can you talk about how important the Wireline business is for the health and profitability of your Wireless business, and how important it is or isn’t to keep those two businesses together over time? Thanks.

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

Thanks, Michael. First off, on the receivable; we are fairly flat, because keep in mind that we continue to securitize the receivable that removes that receivable from our books. So it is consistently flat between $2.5 billion to $3 billion, so it really hasn’t changed much.

On the overall Wireline perspective, look, we have sold the three properties in the South -- Texas, California, and Florida -- because they were islands to us. Very difficult properties to operate from our scale perspective. There’s still a lot of copper in those footprints and Frontier does a much better job with that, and strategically it just didn’t fit for us.

But, look, I think if anyone was to enter the broadband market, the East Coast would be the first place that they would go. We have an incredible footprint that stretches from Washington DC up through Boston. The broadband connection to those homes, along with our Wireless product and the population of that segment, is critical to us. It is a strategic asset for us to continue to market and launch with our Wireless product. Over the top is going to feed into more of that as we go here strategically.

Right now Lowell and I sit and we are very satisfied with the portfolio of assets we have. From an enterprise space, that enterprise asset is very critical to our enterprise customers, both from a Wireless and a Wireline perspective. They are important relationships to us.

Right now, I’m not saying that if someone did come in and take a look at the assets; as we’ve always said we are open to anything. But right now, strategically, we are very satisfied with the asset portfolio we have and it is strategic to us. Right now we are content with what we have.
Mike Rollins - Citigroup - Analyst

Thank you.

Operator

Mike McCormack, Jefferies.

Mike McCormack - Jefferies - Analyst

Thanks. Fran, maybe just a quick comment on margin pacing throughout the year. Now we have more Edge uptake, just how we should be thinking about that typical fourth-quarter seasonality.

Second, on the Wireless side, anything on your radar with respect to leasing plans? And then just finally on the enterprise piece. I know you mentioned pricing and competition there. Just trying to get a sense for if there is something going on that's incredibly irrational or is it just a byproduct, more competition in certain areas? Thanks.

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

Sure, thanks. So, Mike, on the margin pricing; look, I think that the financials speak for themselves. And of course, we will get a lot of flavor around how the EIP helped the profitability and all this.

But again, as Mike and I have continued to say, if you look at total revenue and the total EBITDA margin, that kind of neutralizes out the impact of EIP and you see that we are increasing this year over year. Even if you look at Wireless margin at 56% in this quarter, even if you normalize out the EIP benefit, you are still over 50% margins for that business.

So I think it speaks to itself of the -- we continue to be an and company. We are going to grow and we are going to generate the profitability, and we are going to do this in a very disciplined, manageable approach. We've said that we felt that coming into the year that we would hold our margins, given all the competitive pressures, and we're still on track to do that.

So I think the margin itself speaks for itself. And from a seasonality standpoint, the one thing I would say, going back to the change in the revenue guidance, is, as we look out into the fourth quarter, keep in mind fourth quarter last year was an unusually very high-volume quarter that generated a lot of equipment revenue and the bulk of our sales were still on the equipment subsidy model. And that hovered around the new 6 and 6+ that came out.

I just don't see that the next iconic device is going to be substantially different and, therefore, I don't see that -- and this is just me speaking -- I don't see the volume there in the fourth quarter that we had last year from a total iconic change of the 6 and the 6+. So I think that will also benefit us from just a margin perspective.

On Wireless and leasing plans, look, the leasing plan is just a fancy way to do installment plans, but of course, you get another accounting benefit by putting assets up on your books and being able to amortize them below the EBITDA line. So at this point we have no plans to do any type of leasing arrangement.

Then on the enterprise side, look, as I have said before, 2015 would look like 2014. I still do see some glimmers of hope here, especially in the government sector where we are starting to sign some large contracts. But as you know, in this business, I sign a large contract today; it takes me at least 12 months to implement that before I start to see the revenue benefit.
So I’m looking that there could be some positives here going into 2016 on the enterprise side. Obviously it’s being impacted by FX right now, but this is a very competitive environment with thousands of players who have niches. We do very well on the security side of the house. We are doing well in the data center side on the whole cloud services, but these revenue streams are just not large enough to offset the price compression that we are seeing in IP.

Again, I see some glimmers of hope in IP where maybe it’s starting to stabilize again, and if that happens then we should see some improvement. But right now it would be a cautious outlook from me.

Mike McCormack - Jefferies - Analyst

Great. Thanks, Fran.

Operator

John Hodulik, UBS.

John Hodulik - UBS - Analyst

Thanks. First on the Edge take rate, Fran, how high can this go over time? You gave the guidance for 60% next quarter, but do you see a time where in the not-too-distant future you could phase out subsidized plans and move all towards these Edge plans?

And then the other number that stuck out was the lower churn. You talked about some of the efforts to lower churn. Do you think you can maintain this level of below 1% going forward? Thanks.

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

Thanks, John. On the Edge take rate, look, this is where the market has gone. If you look at all the advertising in the market, it’s around the access point and this is where we are at. So I think that where we are going to end up here is you will never get to 100% overall because of corporate accounts and so forth. They are not going to take an installment-type plan, so I don’t think we ever get to, quote, 100% in our base.

But from a consumer standpoint, yes, I could see us getting to where we are more heavily, very heavily concentrated on the installment side of the house. Quite honestly, as I said, from a frontline perspective it would be much easier for them to sell one product. Simplicity is important to us. You’re going to see us as we gradually move through here; the market is moving us there so we are eventually going to get there.

From a churn perspective, as I said, I think with all the programs we have going we are making very good progress in our base. Our customers are loyal. You’ve seen us running our new ads and some of our customers are coming back to us because they were dissatisfied with where they went. So I think that this all proves to again the basis of how Verizon Wireless has been successful and will continue to be successful is the quality of our network, the consistent performance that our network gives to our customers, and the breadth of that network across the United States.

So that’s really what it comes to. And as I have said before, the number one reason the customer leaves you is because of quality of the network. Price is number two. The quality of the network still is overwhelmingly more important than price. Not to say that customers are not price sensitive, but we think that we can continue to be very competitive and protect our high-value base. So, yes, I do think that we will continue on this track.

John Hodulik - UBS - Analyst

Thanks, Fran.
Amir Rozwadowski - Barclays Capital - Analyst

Thanks very much and good morning, folks. Was wondering if we could switch gears a little bit in terms of the network investment strategy here, Fran. You know, we start to hear things coming out of Washington; 600 megahertz seems to be like pushing for an early 2016 start.

First of all, how do you think about the timing on the reality of that happening? How should we think about your strategy around the need for low-band spectrum? Then sort of a bigger picture question here.

Clearly, focus remains on providing a compelling network experience from your side, particularly if I think about your CapEx investment and shifting towards Wireless. Was wondering if you could talk a bit more about some of the technology evolutions that you folks are embracing. Clearly, when we speak to folks sort of in the push to small cells, perhaps some the software-defined networking at (inaudible), which we haven’t seen from many other players, and stuff along those lines to really try and optimize the network throughput. Any additional color would be most helpful here.

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

On the network side, as far as the incentive auction goes, yes, the FCC is now saying that they are going to hold the auction first quarter of 2016, probably at the end of the first quarter of 2016. As you know, they had a meeting on July 16 where they were going to set the rules, but that actually got postponed. So we will have to wait to look at what the auction rules are and decide whether we're going to participate at the appropriate time.

The only thing I would say is, based on the AWS-3 auction, hopefully we have some lessons learned on what we shouldn’t do with multibillion dollar companies getting favorable treatment. So we will have to see where these assessments come out.

As far as our strategy here, the need for low band spectrum for us is not a great need. As you know, we built out our LTE on the 700 megahertz, which is contiguous across the United States, which is a competitive advantage for us. We then launched our AWS-1 spectrum for capacity and now we’re in the process of revamping our 1900 PCS.

So the key here is to keep in mind that, of our licensed portfolio, only 40% of our license portfolio supports LTE and 87% of the data traffic is now running through LTE. So if you look at our 1900 megahertz, the yet-to-be-deployed AWS-3 which we bought and will be deployed over the next probably 2.5 years out, and then our build strategy which we came out of the auction with in Chicago and New York, we have plenty of capacity to deal with the ramping of what we believe will happen with our OTT product and the continued pursuit of volume in the industry.

Our build out is on track. We do not necessarily need low band spectrum, but that doesn't mean that we would not participate in the incentive auction. Again, we will have to wait for the rules to come out, but obviously we are continuing down the track we set on coming out of the AWS-3 auction. At that point we will have to wait and see what happens with the FCC.

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

Amir, thank you. Marley, we have time for one more question, if you could queue that up I would appreciate it.

Operator

Jennifer Fritzsch, Wells Fargo.
Jennifer Fritzsche - Wells Fargo Securities - Analyst

Thanks, Fran. Following up on Amir’s question on spectrum, in the past you have said you would consider a longer-term lease agreement with a potential partner. Is that still the case? Or given your recent comments just now about capacity, what are your current thoughts on any sort of longer-term lease agreement?

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

Thanks, Jennifer. I always say you never say never, right? Look, we are open to any options, but as far as a leasing of spectrum goes, as I've said before, in order to protect the viability of our network and our planning and our capital allocation, this would have to be almost a lease in perpetuity so that you could never be held hostage by anybody. Because once you deploy a spectrum in your network, if somebody turned around 10 years from now and said I'm not going to lease that you anymore, that would be detrimental to your business and you just can't let that happen.

So I guess under the right terms and conditions it would be something that we could look at, but I would tell you I think that’s very, very difficult given the asset that you are leasing here. So I think that’s the perspective and we’re concentrating on our build.

The one thing I didn’t answer on Amir’s question was SDN and we’re well into that. Obviously LTE in itself is a software-developed network and it gives you the scalability of giving richer network experiences. Our team is working on that and we have been working on that for quite some time.

There’s a lot of things will bring efficiency to the network. There is C-RAN out there. We are in the initial -- obviously 5G is being talked about in the industry. Of course, Asia is involved in 5G and of course we will start to get involved in the standard setting around 5G, so there’s a lot happening in this industry for technology standpoint.

Spectrum is important. It will always be important, but it’s not the only tool we have in our toolbox. From that perspective, we’re concentrating on the strategy that we outlined coming out of the AWS-3 auction.

Jennifer Fritzsche - Wells Fargo Securities - Analyst

Thanks, Fran.

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

Marley, thank you. But before we end the call I would like to turn the call back to Fran for some final comments.

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

Thanks, everybody. Again, thank you for joining us this morning. Just like to end, though, at -- through the first half of 2015 we continued to execute on the fundamentals, we position our business for the future, and we always return value to our shareholders.

On a comparable basis, first-half consolidated revenues were 3.5%. Earnings grew 12.6%. Cash flow from operations was up 11.9%. Wireless revenues increased over $2.5 billion to just under $45 billion.

We positioned ourselves for future growth. We acquired valuable mid-band spectrum in the FCC auction, invested $8 billion in capital year-to-date, and made a very strategic acquisition in AOL. AOL acquisition greatly accelerates our digital media and advertising platform capabilities, which will become a critical element of our OTT strategy and our revenue growth for the future.
We returned $9 billion to our shareholders through the first half of this year, $4 billion in dividends and $5 billion in an ASR program. We certainly look forward to a very positive second half of 2015 with confidence in our ability to execute our strategy and create value for our customers, our shareholders, and our employees.

Thank you again for joining us 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.