Good morning and welcome to the Verizon second-quarter 2011 earnings conference call. At this time all participants have been placed in a listen-only mode and the floor will be open for questions following the presentation. (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. John Doherty, Senior Vice President, Investor Relations, for Verizon.

Thanks, Brad. Good morning and welcome to our second-quarter 2011 earnings conference call. Thanks for joining us this morning.
I'm John Doherty. With me this morning are Fran Shammo, Verizon's Chief Financial Officer, and Lowell McAdam, Verizon's newly elected President and Chief Executive Officer, effective August 1.

Before we get started, let me remind you that our earnings release, financial and operating information, the investor quarterly, and the presentation slides are available on our investor relations website. This call is being webcast. If you would like to listen to a replay you can do so from our website.

I would also like to draw your attention to our Safe Harbor statement. 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 also contains certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are also on our website.

Before we get started I would like to point out that our second quarter includes the results of Terremark, since the acquisition closed in early April. As we go through the presentation we will point out the effects on certain growth rates as appropriate.

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

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

Thanks, John, and good morning, everyone. Before we get into the details, let me start with some brief overview commentary, adding my perspective to our second-quarter results.

We had a very strong quarter, continuing the positive momentum from earlier this year. Our results clearly demonstrate that we are executing well in our key areas of focus and driving profitable growth.

Our top-line revenue growth accelerated to 6.3% year-over-year, which is a 100 basis point increase from our first-quarter growth rate of 5.3%. This was our strongest quarter of consolidated revenue growth in 2.5 years.

In Wireless, we had an outstanding quarter of customer growth, with strong demand for smartphones and Internet data devices and increasing service revenue, driving total revenue growth of 10.2%. We also saw continued improvement in Wireline revenue, with higher Global Enterprise revenue driven primarily by improvements in strategic services.

EBITDA margins this quarter expanded sequentially in both Wireless and Wireline as we continue to focus on driving top-line growth as well as improving our operating efficiency. In Wireless, our EBITDA service margin expanded 170 basis points from first quarter to 45.4%, an impressive result in light of increased postpaid customer growth, continued smartphone penetration, and Internet device expansion. In Wireline, the EBITDA margin increased by 20 basis points to 23.8%, our fifth consecutive quarter of margin improvement, through a combination of better revenue performance and our continued focus on cost containment.

Our second-quarter earnings of $0.57 per share is a very solid result, up from $0.51 in the first quarter, and demonstrates good execution and the strength of our business model and the strategy that we discussed with you back in January. With that, let's begin a more detailed review of the quarter on slide 4, starting with the consolidated results.

As I just highlighted, we had strong top-line growth in the second quarter, with consolidated revenue increasing to $27.5 billion, up $1.6 billion or 6.3% year-over-year. By capitalizing on the growth opportunities in Wireless, FiOS, and Enterprise strategic services, together with improving our Wholesale business, our consolidated revenue trends continue to be very positive.
Our consolidated EBITDA for the second quarter totaled $9 billion, up 5.2% year-over-year. On a sequential basis, our consolidated EBITDA margin expanded 130 basis points to 32.7%.

In terms of earnings, again as I highlighted in the overview, we had a very strong quarter, reporting $0.57 of EPS without any nonoperational or special items. This compares favorably with $0.51 last quarter and $0.51 in the second quarter of 2010 after making the necessary adjustments for the impact of the divested operations and nonoperational charges in that period. So a solid performance as far as driving growth to the bottom line, representing an 11.8% increase in EPS on both a sequential and year-over-year basis.

Year-to-date earnings totaled $1.07 per share, up 8.1% over the same time last year. Again, our overall first-half performance confirms the strength of the business and the path that we are on to create long-term shareholder value.

Let’s turn to cash flow and capital spending on slide 5. Our cash flow results for the quarter showed a significant sequential improvement, driven by higher revenue growth, margin expansion, and favorable changes in working capital, some of which were timing related, as I indicated last quarter.

In terms of capital expenditures, while we have had a higher level of spending in the first half compared with last year, our additional investments are in support of increased customer volumes and higher revenue growth in Wireless. First-half CapEx this year totaled $8.9 billion, of which $5.4 billion was Wireless.

As we discussed before, we started this year more aggressively in Wireless. To date, our network spending on 3G is well ahead of our capacity requirements for the full year, and we have also spent a bit more on 4G LTE, consistent with our deployment plans. Based on our current forecasts, I expect Wireless capital expenditures to decrease in the second half of 2011.

In Wireline, capital expenditures totaled $3.1 billion for the first half, which is down 5.9% year-over-year. On a consolidated basis, capital spending in the second half will be lower than the first half. For the full year we are targeting capital expenditures to be similar to 2010 at about $16.5 billion.

In terms of free cash flow, we have generated $3.9 billion for the first six months. And although this is lower than recent trends, our cash flow outlook for the balance of the year remains very strong, especially in light of the lower capital requirements.

From a balance sheet perspective, our financial position remains strong. Net debt at the end of June was $47.7 billion, and our net debt to adjusted EBITDA ratio remained at about 1.4 times. We also closed the Terremark acquisition and refinanced about $800 million of their debt at more favorable rates.

On slide 6, we have displayed second-quarter revenues for each of the last three years, which is a good illustration of the transformation and growth of our revenue base. As we pointed out in prior quarters, about 77% of our revenues are in strategic areas of higher growth, up from about 70% two years ago.

With our continued emphasis on advancing the deployment of our 4G LTE network in Wireless, with our all-fiber network in Mass Markets, and through our global reach and cloud-computing capabilities for Enterprise customers, we continue to be well positioned to drive higher top-line growth as the strategic transformation of Verizon continues.

Let’s now move into a review of the segments, starting with Wireless on slide 7. Our Wireless business had a very impressive quarter, with accelerated growth in postpaid connections; higher service revenue growth; continued strong postpaid phone ARPU growth; improvement in customer churn; and greater profitability and free cash flow. Total revenue grew to $17.3 billion in the quarter, up 10.2% year-over-year with a 6.6% increase in total service revenue. This year-over-year growth in total service revenue is 30 basis points higher than the 6.3% we reported in the first quarter.
Total quarterly data revenue grew to $5.8 billion, up $1.1 billion or 22.2% year-over-year. Data revenue now represents 39.5% of our total service revenue. As you know, a key driver of data growth has been the increased penetration of smartphones. We continue to make good progress on that front, increasing penetration of our retail postpaid phone base from 32% last quarter to 36% this quarter. Just one year ago, smartphone penetration was 21%.

Within the postpaid category, we are also seeing very strong demand for our Internet data devices, particularly 4G Mobile Hotspots, or MiFi devices and dongles. We are the market leader in these devices, with a large and growing number of these customer connections now representing more than 7.5% of our retail postpaid base.

In many cases these data-only devices represent an additional connection, as a growing number of customers have more than one device. I would also point out that while the revenues are clearly additive to our top line, these devices have a very short payback period, as they typically carry a much lower subsidy than the phones within our portfolio.

Let's take a closer look at our connections growth on slide 8. We are clearly gleaning marketshare in the retail postpaid market, driven by increasing demand for our unmatched portfolio of 3G and 4G LTE handsets and Internet data devices.

During the second quarter we added 2.2 million total connections, of which nearly 1.3 million were retail postpaid. This was our highest quarter of postpaid additions since the fourth quarter of 2008. Within the 1.3 million postpaid additions about 60% were phones.

In the retail prepaid category we had net additions of 61,000. Of note were 241,000 prepaid tablets, which are contributing to sequential growth in prepaid ARPU.

Outside of the retail category we added about 890,000 wholesale and other connections this quarter. Only a small percentage of these net adds were the typical reseller phone devices. A majority of these additions were vehicle tracking, telematics, and machine-to-machine devices.

While our focus will continue to remain very heavily on the retail postpaid market, which represents more than 80% of our total connections, we're also broadening our portfolio of machine-to-machine connections. While these connections generally have lower monthly revenue profiles, they represent incremental revenue at a very high profit margin.

At our Verizon Innovation center in Waltham, companies, entrepreneurs, and others across the LTE ecosystem are coming together to create the next generation of products and solutions that will deliver the power and possibilities of 4G LTE. We expect this to be an increasing area of growth for us in the future and will continue to expand our M2M offerings.

Total device sales, gross adds, and upgrades were strong once again this quarter. We had postpaid gross adds of more than 3.5 million, which is an increase of more than 20% year-over-year, and about 9% of our retail postpaid customer base upgraded to a new device.

About 90% of the postpaid devices sold this quarter were phones, with roughly 60% of these being 3G and 4G smartphones. Also noteworthy is the fact that half of all Internet data device sales this quarter were 4G LTE.

This strong demand across all product lines is not only increasing our postpaid connections and driving revenue growth, but is also strengthening our industry-leading customer loyalty. Our churn metrics this quarter were excellent, with retail postpaid churn of only 0.89%, our lowest in three years.

Next, let's turn to slide 9 and take a closer look at retail postpaid ARPU. Throughout last year we saw accelerating retail postpaid ARPU growth, starting with 0.6% in the first quarter and steadily ramping to 2.5% in the fourth quarter.
In the first quarter of 2011 our retail postpaid ARPU growth was 2.2%. This quarter, retail postpaid ARPU growth was 1.9%. To enhance the understanding around the growth trend of this blended metric, it is important to note that there are a few different dynamics occurring within the category which, while having an impact on the growth rate of the ARPU metric, are quite positive and strong indicators of future revenue growth.

The first thing to recognize is that retail postpaid phone ARPU is higher than the blended postpaid metric of $54.12. As we have illustrated on the slide, the rate of growth has increased significantly in the past year to 3.2% this quarter, driven of course by the increase in smartphone penetration.

That said, within the postpaid category the significant unit growth in Internet data devices, while adding total service revenue growth and expansion of the category, is having a dilutive effect on the total postpaid ARPU rate of growth at this point in time.

Within the Internet data device category, we are seeing strong demand for our Mobile Hotspot or MiFi devices, dongles, and tablets. While the unit growth is very strong and a key area of focus for us in expanding this category, the average ARPU on these devices is less than $54 and is declining on a year-over-year basis.

We are seeing some migration of 3G customers who were paying about $60 per month to a new 4G device at a $50 per month price point. These pricing plans are intended to expand the category while delivering high profitability, and we already see evidence of this in our second-quarter margin result.

The strategy within this category of devices is to build share so that we can benefit from the significant growth in usage we anticipate in the future. We are confident that the innovation will drive the development of bandwidth-intensive video and data applications that will appeal to consumers and provide utility for Enterprise customers.

By gaining a strong foothold in this market, particularly when you think about the potential for tablets, we have a great opportunity to benefit from this increased video and data usage. Together with our move to tiered pricing, where the next price point for 10 gigabytes is $80 per month, we believe that as we move into 2012 and 2013 these trends will provide ARPU accretion in this category.

To date, the very strong demand for these devices is resulting in strong revenue growth, albeit at lower ARPU than with phones. The other positive element to the sale of 4G LTE devices is the migration of data traffic from our 3G to our 4G network, which is highly desirable from a capital efficiency and profitability perspective and will help us drive improved returns into the future.

Stepping back from the postpaid ARPU metric, it is important to note that total data revenue continues to be sourced primarily from Web and e-mail services, which increased to $3.4 billion this quarter, up more than 35% from a year ago. Messaging, which makes up about one-third of data revenue, is still showing growth albeit at a slower pace, at nearly 6% on a year-over-year basis.

With regard to Apple iPhone 4, we activated 2.3 million units this quarter, bringing our total to 4.5 million since we started selling the phone in early February. Sales have been steady and in fact it is one of the top-performing phones on our 3G network in terms of voice quality, with the least number of dropped or lost calls and high overall customer satisfaction.

As far as 4G devices are concerned, we have been very pleased with the sales to date. As you know, we have nine LTE devices in the market today -- three smartphones, two Mobile Hotspots, three laptop dongles, and one tablet for pre-order with availability very soon. During the quarter we sold a total of 1.2 million 4G LTE smartphones and Internet data devices.

In terms of an update on our LTE deployment, we are now providing service in 102 markets covering more than 160 million POPs. We are well on track with our plan to have coverage of 185 million POPs or better by the end of 2011.
Let’s conclude our wireless segment review with a discussion about profitability on slide 10. In the second quarter we generated $6.7 billion of EBITDA, an increase of 2.5% year-over-year, and expanded our service EBITDA margin by 170 basis points sequentially to 45.4%.

This margin is a very strong result against the backdrop of an increasing number of device sales. To me, this speaks to our strategy of increasing growth and profitability, and clearly demonstrates how we create long-term shareholder value.

Again, the combination of top-line growth and effective cost controls give me confidence in our ability to sustain our industry-leading profitability and free cash flow generation. We are encouraged by the strong demand for our products and the positive implications for revenue growth.

Going forward you can expect us to effectively deliver both growth and profitability, with a continued strong focus on gaining share in the retail postpaid market. Within this market, we will continue to expand the Internet data device category, including tablets, and further increase the penetration of smartphones to drive revenue growth and long-term profitability.

Let’s move to our Wireline segment next on slide 11. We continue to see improving revenue trends in our Wireline business. Total revenue in the second quarter was $10.2 billion, a 0.3% year-over-year decline. While the inclusion of Terremark added about 100 basis points of growth, this still marks solid improvement over the 2.2% decline in the first quarter.

In Mass Markets, our FiOS broadband and video products continue to drive a positive shift in our revenue mix. FiOS now accounts for 57% of consumer revenue, up from 48% a year ago. FiOS revenue in the quarter grew 20.7% year-over-year, and FiOS ARPU is more than $146.

In Global Enterprise, revenue growth improved to 3.6% year-over-year, driven by strong strategic services growth of 17.8%. Again, the inclusion of Terremark added $98 million to second-quarter Enterprise revenue.

As we have said, strategic services are becoming a much larger portion of our revenue mix, now representing 48% of total Enterprise. Within this category, advanced services like managed network solutions, contact center solutions, IP communications, and our cloud offerings are growing very nicely.

From a profitability perspective, segment EBITDA increased $128 million or 5.5% year over year, resulting in a 140 basis point improvement in our EBITDA margin to 23.8%, primarily as a result of our workforce reduction initiatives in 2010. On a sequential basis this marked the fifth consecutive quarter of EBITDA margin improvement.

Let’s take a closer look at our revenue performance, starting with Mass Markets on slide 12. Within the Mass Markets category, consumer revenue at $3.4 billion grew 1.3% versus last year. Consumer ARPU grew to $92.44, an increase of 9.4% from a year ago. Residential access line loss this quarter was 8.2% compared with 10% a year ago.

The continued penetration of our broadband and video products have increase the scale of our FiOS platform, and it is now significant enough to more than offset the secular and competitive pressures in this part of the business. We had another solid quarter of customer growth in FiOS TV, adding 184,000 subscribers for a total of 3.8 million TV customers. Our FiOS TV penetration at the end of the quarter was 30%.

On the broadband side we added 189,000 new FiOS Internet customers in the quarter. Our FiOS Internet customer base increased to 4.5 million, representing 34% penetration of homes open for sale.

By adding in our 4.1 million high-speed Internet or DSL customers, we ended the quarter with a total of 8.6 million broadband connections. This reflects an overall increase of 62,000 broadband connections. Our strategy of driving penetration in existing markets has been effective, and we intend to maintain this momentum as penetration continues to improve in all of our FiOS markets.
Let’s move next to our business markets on slide 13. Within Global Enterprise, strategic services continued to drive the year-over-year improvement, led by very strong growth in advanced services such as managed network, call center, IP communications, and our cloud offerings. As we experienced last quarter, the absolute dollar growth in strategic services outpaced the dollar decline in core Enterprise services.

In Global Wholesale, revenues declined 7.4% year-over-year. As we have discussed, our route rationalization strategy resulted in a substantial decline in international voice revenue of about $111 million this quarter on a year-over-year basis. Since these price changes were initiated in mid-2010, we have one or two more quarters to work through before the comparative impact of these actions moderates.

Absent these effects, second-quarter Global Wholesale revenues declined 2.9% year-over-year. This decline is primarily in domestic voice, where we continue to experience secular pressures and lower usage volumes.

I will wrap up here with a summary slide to highlight our second half of 2011 areas of focus. We had a strong first half of the year, demonstrating solid execution of our strategy while increasing profitability. In the second half of the year you can expect us to continue to drive strong top-line growth in our key strategic areas.

We have great momentum in Wireless and we expect to build on that strength. We are seeing continued demand for our existing 3G and 4G LTE handsets and Internet data devices, with more smartphones, tablets, and data devices in the pipeline.

In FiOS, we will continue to drive higher penetration in our existing markets and capture pent-up demand in new markets. In the Enterprise space, we continue to enhance our position as a leading global provider in the information technology solution space. With the integration of Terremark well underway, we have improved our ability to combine solutions around the network, data center, security, and cloud infrastructure, providing us with a significant opportunity in this high-growth part of the market.

While achieving higher top-line growth is great, we must ensure that this is profitable and sustainable. Our focus is on driving growth in products and services that are not only increasing our market share but also expanding margins and improving profitability.

I can assure you that the business will remain very focused on our cost structure and achieving meaningful cost reductions. The strategic actions and execution of our plans have strengthened our Wireless and Wireline businesses. Our objective is to continue to drive increases in free cash flow from improved operating performance, disciplined capital spending, and the efficient use of working capital.

We intend to maintain a strong balance sheet and a very competitive dividend, as this is critical component of shareholder value creation. So I will end there, and it gives me great pleasure to now turn the call over to our newly elected President and Chief Executive Officer, Lowell McAdam.

Lowell McAdam - Verizon Communications, Inc. - President, COO

Thank you, Fran, and good morning, everyone on the call. Today is, obviously, an important day for Verizon as we transition the CEO role from Ivan to me. This has been a very smooth transition by any measure, and we have Ivan to thank for that. He has had a very clear plan from the beginning, and that is to keep the focus on customers and our investors.

I want to be sure that I say to investors on my first day on the job that I understand the obligations that come with this position, and that is to deliver bottom-line results. Ivan has built a tremendous Company over his 18 years of leadership. He has moved this business from a regional wireline voice business to the leading national wireless company and to a global enterprise technology company.
I believe we can accelerate that transformation to a global solutions and networking company. I believe that the pieces are already in place to do that and that we are showing good momentum in our results to further fuel that transformation.

This morning Fran has done his usual highly professional job explaining the results. A few things stand out for me.

First, Wireless continues to show strong growth and industry-leading profitability. We have been through many transitions of devices and technologies. The consistency of results in the face of a highly competitive and dynamic market show the underlying strength of our team and our operations.

Second, the FiOS strategy has proven itself by taking share and gaining revenues. Our Enterprise strategy, fueled by the MCI, the Cybertrust, and now the Terremark acquisition, is producing a highly successful portfolio of services that are being rapidly adopted by our customers.

And finally, I see a cost-control mindset that is driving overall profitability. While my optimism is certainly based on performance, I also see tremendous potential ahead.

First, I am pleased with the organization's structure and the management team that we put in place last October. They are rolling up their sleeves and diving into many opportunities to reengineer our processes and policies. This will streamline our operations to deliver better service to our customers and better cost performance.

Second, we have leading-edge technology platforms in FiOS, LTE, our IP backbone, and now the cloud. These investments will pay dividends now and in the future. As we see far more demand for video, data, and enterprise applications, we are better positioned than any other company to meet evolving customer needs.

Third, we have begun to effectively partner to drive innovation for our customers. Some of the most innovative companies in ours and adjacent industries are working in our existing Innovation Center in Waltham, Massachusetts, and the soon-to-be-open sister center in San Francisco. We see an exciting roadmap of new consumer and business products on the horizon.

Finally, I am pleased with the evolution of our partnership with Vodafone. We are clearly moving from a purely financial partnership to an operating partnership.

We are now facing our largest multinational customers as one team. We have aligned our product and our technology roadmaps, and we are beginning to purchase infrastructure together. All of these actions will begin to enhance our revenue and our cost profiles.

As my last comment I would say we have just finished taking the top 300 leaders of Verizon through a class we call Leading for Shareholder Value. Fran and I teach significant sections of the class, which focuses on how we can drive the business to higher returns. I am very pleased by the reaction of the senior team and their commitment to our success.

We use the term -- there is always a higher gear; meaning, no matter where you are in the business there are opportunities to improve. That is what makes being part of Verizon so exciting and that is what positions us so well for the future.

With that, I will turn the call back to John. Thank you.

John Doherty - Verizon Communications, Inc. - SVP, IR

Thanks, Lowell. Brad, that concludes our opening segment of the call. Let's open it up for questions.
John Hodulik - UBS - Analyst
Okay, great. Thanks. First, congratulations, Lowell, on the new role at Verizon.

Lowell McAdam - Verizon Communications, Inc. - President, COO
Thank you, John.

John Hodulik - UBS - Analyst
I guess the question is for Fran. I am trying to maybe get a sense for the trends in Wireless ARPU and basically what happened between the 2.8% growth in March and what we saw in the first quarter. It sounds like -- or second quarter.

It sounds like it is a mix -- it’s a combination of increased mix of connected devices and some ARPU pressure within each category. Specifically you mentioned the migration from 3G to 4G putting pressure on ARPU because those are lower-priced devices. If you could give us a sense for maybe the magnitude of which one was the larger of the drivers.

And two, maybe how far through that migration of customers from 3G to 4G are we? How much more pressure are you expecting from that specific issue? And maybe give us a sense for what you expect for ARPU trends going forward on the postpaid side.

Fran Shammo - Verizon Communications, Inc. - EVP, CFO
Good, John. Thank you. So this is -- I am glad the question came because this is one that is important. If you look at -- we have actually disclosed the new metric that we now call Phone ARPU, which consists of our smartphones and our feature phones. Again this quarter we saw a very good uptick from feature phone to smartphone, about 53% with the Apple phone, transforming from the feature phone into the smartphone. So we are seeing that 3.2% continuing into the future.

I think the important thing here though is on the Internet devices. It is important to know because, if you go back to October of last year when the market changed pricing on all of Internet devices, we actually launched Internet pricing at $35 3-gig, $50 for 5-gig, and $80 for 10-gig. As we saw the market and we expanded the market in this category with also the innovation of the 4G LTE network and now all of the devices that we have on that, in May we actually pulled the $35 price point from the marketplace.

So that was part of the contribution of why we saw an acceleration of the dilution in the Internet ARPU. We have now since pulled that; so now the entry point is $50, stepping up to $80. So we have made that change and I think that in itself will start to see improvement in the third quarter.

But needless to say, the amount of devices and the volume within the 4G network we are very pleased with, with moving 1.2 million devices this quarter. As you said, John, we are seeing folks who are coming off of their contracts on 3G, moving over to the 4G, and stepping down from their legacy pricing of the $60 and $70 price points down to the $50 price point.

But I also want to make sure that it’s important to realize that these devices are much lower subsidy; and the profitability on these devices are extremely high. So it is the right thing to do. We are expanding the category.
We are seeing the expansion with our tablets, with our 4G network. With tablets we now have our first 4G tablet coming to marketplace; it can be pre-ordered. And we think that that will also make a dynamic change here.

The other thing that I want to talk about ARPU and something that I have mentioned before is, because of the dynamics of the industry and the way it is changing, we now have a number of tablets being sold as prepaid. So what you saw this quarter is a sequential accretion in the prepaid ARPU because we are placing more and more tablets onto a prepaid pricing system.

The other thing that is interesting to note is more than 50% of these prepaid customers are buying at $35 and higher price points, even on the prepaid plan. So the strategy is working. I think we will continue to expand this, but I do think that we will see continued pressure in the Internet device category.

John Hodulik - UBS - Analyst
So, Fran, do you expect total service revenue growth to continue to accelerate from here?

Fran Shammo - Verizon Communications, Inc. - EVP, CFO
I believe we are going to see continued acceleration of service growth.

John Hodulik - UBS - Analyst
Okay, thanks.

Lowell McAdam - Verizon Communications, Inc. - President, COO
John, this is Lowell. Just to -- if I look back over my 20-some years on the Wireless side, every time we brought in new devices, we brought in new use cases, we saw nice expansion of the market. And I think that is just what you see going on here today.

In some ways it is similar to when we all went to family share plans. There was a big concern over what ARPU was going to do, but we expanded the market nicely, great profitability. And I think that is exactly what is going on here now. So we feel very good about the position.

John Doherty - Verizon Communications, Inc. - SVP, IR
Thanks, John. Brad, can we move on to the next question, please?

Operator
Simon Flannery, Morgan Stanley.

Simon Flannery - Morgan Stanley - Analyst
Thank you very much. Good morning and congratulations as well, Lowell. You talked about the Vodafone partnership and opportunities.

Can you talk about the dividend potential, where the negotiations stand, and what sort of timing and type of payment we should be expecting there? Thank you.
Sure. I will let Fran talk specifically about the dividend here, but I think that Vittorio’s and my goal over the last 18 months have really been to try to turn the temperature down a little bit and to improve the bottom line of the relationship. So, we have really focused -- because we knew LTE was on the horizon here, we started out by focusing on aligning the technology roadmaps. That will go all the way through purchasing network equipment together, as they are a little bit behind us because they don’t have the spectrum for LTE; but they are beginning that ramp now.

We also have heard very clearly from the large Enterprise customers that combining the assets of Verizon business — meaning the global IP backbone and their data center infrastructure, and that is an exclamation point went on that with the Terremark purchase — that we could provide a global fixed, and mobile solution. So we have now -- we have teams that it is one team made up of Verizon and Vodafone employees that face our top 50 accounts, and we are going to be expanding that very quickly.

There’s a number of other smaller, but those are the main ones. Now regarding the dividend, we have been very clear that there will be a dividend. Why don’t I let Fran just talk a little bit about the mechanics?

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

Yes, thanks, Lowell. I think, Simon, at this point I have made my comments on the dividend. I don’t think there is really anything else to comment on, on the dividend.

Simon Flannery - Morgan Stanley - Analyst

Okay, thank you.

John Doherty - Verizon Communications, Inc. - SVP, IR

Thanks, Simon. Brad, can we move on to the next question, please?

Operator

Tim Horan, Oppenheimer.

Tim Horan - Oppenheimer & Co. - Analyst

Good morning. Fran, I might have missed it, but did you comment on what you are seeing in terms of LTE speeds and maybe overall monthly data usage?

Then on the margin front you had a great sequential growth here, about 130 basis points on a consolidated basis. Could you talk about maybe the trends over the next few quarters and where you think you can be longer term at this point?

You have had almost a decade of restructuring the business and a lot of, obviously, upgrade to the infrastructure. And you’re still substantially below where the margins used to be historically. Thanks a lot.
Fran Shammo - Verizon Communications, Inc. - EVP, CFO

Yes, Tim, on the LTE speeds we are seeing consistent from what we had disclosed before. We don’t get into disclosure of any 4G LTE device usage at this point. Again I think it is too early to really get a good average on what those speeds will be amongst all the different devices that we have there.

As far as on the consolidated margin basis, I think I will be consistent to say that our business strategy and what we disclosed back in January, I think it proves that we have proven that the strategy is working. We are expanding the market. We are growing our top line. And I think that the margin will follow here based on what Lowell just said, where our main points of concentration are, which is the top-line growth in all of our different business segments and taking costs out of the business.

Tim Horan - Oppenheimer & Co. - Analyst

Thank you.

John Doherty - Verizon Communications, Inc. - SVP, IR

Thanks, Tim. Brad, next question, please.

Operator

Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs - Analyst

Hey, thanks. Good morning. Maybe a couple questions, first on capital spending. You obviously talked about flat this year. I am just wondering from here if there are opportunities. Obviously FiOS spending starts to wind down. Would you expect to reinvest the declines in FiOS spending into either Wireless or Enterprise? Or do we continue to have an outlook of flat to maybe down capital spending as we look beyond the year?

Then second, just on Enterprise, maybe some of the SME trends. Choppy macro data points from here. Do they give you any pause about the momentum you are seeing in that business as you look at the balance of the year? Thanks.

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

Okay, I will answer the first one, Jason; I will let Lowell take the Enterprise one. On the capital spending side I think we will just stick with 2011 at this point.

As you know, we spent $8.5 billion worth in the units for a total of $8.9 billion for the first half. As I said back in January we would be a little different this year because historically we have always kind of accelerated our capital expend through the year. And I was very clear at the beginning to say we would have an acceleration in the first half and then a decline, because we felt the capacity of EV-DO deal was built out; and we still are very comfortable with that projection.

So you should see that decline coming in the second half of this year. I think at this point we know that we still have LFA requirements on the FiOS build of about 1 million homes for the next two years. So I don’t see any major change on premise pass perspective at least for the next two years out.
We said that we would commit on passing 18 million homes. And Lowell and I have said that we would stop there; and then based on penetration rates into the future, then we will make those decisions. So at this point we will stick with the flat for 2011, and we will come back later and talk about the outer years.

Lowell McAdam - Verizon Communications, Inc. - President, COO

On the Enterprise question, Jason, and macro trends, I would love to be able to tell you that we see significant improvement in the overall economic outlook. But we can’t really say that at this point.

What we see is a shift. Whereas two years ago you were seeing a lot of enterprise expansion, now we are actually able to capitalize on the cost-reduction plans of these enterprises. So I think that is why cloud is picking up significantly for us, as well as some of our other strategic services, because the IT department is looking for an opportunity to take advantage of our scale and our applications. So they are shifting -- we are seeing some nice shifts of business.

But as far as overall, do we see the economy coming out of this flat plateau we have seen? No, I can’t say that we see that.

John Doherty - Verizon Communications, Inc. - SVP, IR

Thanks, Jason. Brad, could we move on to the next question, please?

Operator

Michael Rollins, Citi Investment Research.

Michael Rollins - Citigroup - Analyst

Hi, thanks for taking my questions; and Lowell, congratulations. Just coming back to the Wireline side, can you help frame the margin opportunity for Wireline both over the next couple quarters and next few years? Especially in front of the labor negotiations; and maybe within that context you could give us an update there. Thanks.

Lowell McAdam - Verizon Communications, Inc. - President, COO

Okay, why don’t I just make a comment -- this is Lowell -- on the labor side, Mike? And then Fran can add additional thoughts on the --.

I think the tone is good with the union so far. We have lots of dialogue. I think they have been very professional. We understand and I think -- I won’t speak for them; but it is clear that when you see the core access line decline and you see the pressures on the Wireline business, that some things do need to change.

Yes, we have asked for some changes in our work rules; and we have asked for them to consider coming on to the general employee and management medical plans. Those are probably the big issues.

I think we are just coming into the time where we enter into serious negotiations as we get close to the August 6 date. I am optimistic that we will be able to work something through that will be fair and equitable to both sides.
Fran Shammo - Verizon Communications, Inc. - EVP, CFO

Yes, Michael, on the margin side I think I have been pretty consistent, and we have delivered consecutive margin improvement for the last five quarters. I will commit again that our business strategy is to continue to improve the Wireline margin through top-line growth as well as cost containments.

As Lowell always tells me, there's plenty of pots of gold out there to go after in the Wireline business. So we will continue to take costs out and really concentrate on those strategic revenue growth opportunities within the Wireline business consisting of FiOS, the Enterprise side, and especially with the acquisition of Terremark.

So I think our plan is there. We just have to execute on that strategy.

Michael Rollins - Citigroup - Analyst

Can you disclose the ending net debt balance for Verizon Wireless?

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

For this quarter it is [$7.3 billion] (corrected by company after the call).

Michael Rollins - Citigroup - Analyst

Thank you.

John Doherty - Verizon Communications, Inc. - SVP, IR

Thanks, Mike. Brad, let's move on to the next question.

Operator

David Barden, Bank of America.

David Barden - BofA Merrill Lynch - Analyst

Hey, guys. Thanks for taking the question. And Lowell, congrats again from our side. Two questions if I could, real quick.

Number one, even stripping out Terremark from the Global Enterprise, it was a nice healthy tick up in 2Q versus 1Q. But we didn't really see that in the small/medium business segment. Could you talk about the different dynamics that are driving those kind of businesses in different directions right now?

The second if I could, just quickly on the iPhone and LTE sales. Could you talk about what percentage was new to the base and what percentage was upgrades? Thanks.

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

Sure, Dave. Thanks. So with that, on the small business side -- and I am assuming that you are -- let me just get a clarification. You are looking at the really the SOHO business within the Wireline segment, which was actually down by 5.2% this quarter.
I think what is happening here is that we are seeing additional line loss in that segment. Now the actual Internet and broadband connection and that segment was actually positive for us this quarter. But we did see an acceleration of line loss.

I think what I would contribute it to is, if you look at the national startup of small businesses, we are down on a national basis over 50% from where we were last year on startups. So I think it is inflection of we don’t have as much coming in the door to offset that line loss. The line loss is not increasing, but it is consistent.

So I thought we – I think we saw a little bit of a different dynamic in that zero to 20 SOHO business which created that acceleration there.

But it is nothing that I am overly concerned about. It is not a big portion of our portfolio. But it is definitely something that Lowell, I, and the team are very focused on that we need to turn here in the future.

Then on the iPhone-LTE mix, the iPhone upgrade to new was pretty consistent with the first quarter -- 22% to 23% new, and the rest were upgrades.

David Barden - BofA Merrill Lynch - Analyst
Great. Thanks, guys.

John Doherty - Verizon Communications, Inc. - SVP, IR
Thanks, David. Brad, let’s move on to the next question.

Operator
Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst
Hey, guys. Thanks. Wondering if we can dig in a little bit on the handsets. First, if you could talk about the smartphone mix of handsets overall. At the beginning of the year we talked about that going up to 50%, and it doesn't look like it is going to quite make it. Do you see anything in the second half to ramp up that upgrade rate to get the smartphones higher?

Then second, if you could help us on the LTE of 1.2 million. Can you give us any kind of break out between phones and data devices? Thanks.

Lowell McAdam - Verizon Communications, Inc. - President, COO
Let me take the first part of that one. I think, Phil, the handset and smartphone mix, we like the gross add mix that we see coming in here. We are in the roughly 60% range.

We are probably what I would view as maybe a quarter behind what we had talked about in January, primarily because we expected an iPhone 5 refresh sometime this summer.

We don't know when the next one is going to come out. You will have to ask Apple that. But we expect that probably sometime in the fall, and I think you will see a significant jump there when we get to that point.
On the LTE side, I can’t tell you how pleased I am at how the device manufacturers have stepped up with all kinds of devices. We are beginning to see even in the machine-to-machine space LTE modules, because the latency is so much better than we have in a 3G environment. Our fourth-quarter lineup is going to be very robust.

You have seen -- you have gotten a little bit of a peek at that through devices like the Samsung Charge. So the screen density is so significantly better than what we have seen in the past.

So I think we are going to have probably in my entire career the best fourth-quarter lineup of devices I have seen, which will shift that mix that you talked about.

**Phil Cusick - JPMorgan - Analyst**

Great. Thanks, Lowell.

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

Then, Phil, on the -- just the breakout of LTE, what I will say, because I’m not going to break out individual devices here. But what I will say is if you take our 4G devices and our Apple device, it accounted for 69% of our net adds for the quarter. So that is definitely executing on the strategy that we laid out for our growth this year.

**Phil Cusick - JPMorgan - Analyst**

Thank you.

**John Doherty - Verizon Communications, Inc. - SVP, IR**

Thanks, Phil. Brad, let’s move on to the next question.

**Operator**

Michael McCormack, Nomura.

**Michael McCormack - Nomura Securities - Analyst**

Hey, guys. Thanks, just maybe digging a little deeper on the Wireline Enterprise trends, can you give us some sense for what you are seeing at the customer level as far as demand goes? Then also in the competitive environment, the pricing behavior among the bigger carriers.

Then on the Wholesale side, do you guys anticipate that you can get that revenue stream to something that is more flattish over time given the changes you have made?

Then I guess lastly on the cash flow side, Fran, what should we be thinking about? It is probably a little early to be discussing this, but the employee retirement benefits on a going-forward basis, and then deferred taxes, given bonus depreciation rolling off. Thanks.
Okay, Mike. So on the Enterprise side and the trends I think what we are seeing is we are continuing to see improvement in our trends from an overall business perspective. And obviously with the Terremark acquisition we have really put a sounding board out there for ourselves in the cloud space. You saw that we split out that revenue of Terremark, which grew almost at a 30% clip year-over-year. So I think that strategy is there.

What we are seeing, quite honestly, is a lot of Enterprise customers are coming to us and asking us what solutions do we have in order to cut their costs. Obviously a strategy around cloud is really the pivotal point of how we can cut Enterprise costs. Now, the major concern they obviously have is around the security of that cloud.

We think that being number one in security and the portfolio that we have from our Cybertrust acquisition and what we just acquired from Terremark, we really do believe we are second to none in the marketplace as far as security expertise. So I think that is starting to build momentum here both on the overall Enterprise space and actually on a global basis for us.

On the Wholesale side, as I said, this international voice you saw this quarter -- we declined down to 7.4% from where we were about 11% in the last two quarters. I think we will continue to make progress there as we get back to an apples-to-apples comparison.

As I said before I am bullish that said -- if these trends continue I do still think that in the fourth quarter we could be back on a positive growth for the entire Wireline segment for us.

Then from a cash flow perspective and income tax and all that, that was all built into our forecast for free cash flow. As I said in the first quarter, we were low because of some timing-related issues. We came back to the range I gave; and I am confident that with the decrease in our capital spend we will deliver higher cash flow in the second half of the year.

Michael McCormack - Nomura Securities - Analyst

Great and congrats, Lowell.

Lowell McAdam - Verizon Communications, Inc. - President, COO

Thank you, Mike.

John Doherty - Verizon Communications, Inc. - SVP, IR

Brad, let's move on to the next question, please.

Jonathan Chaplin, Credit Suisse.

Thanks very much, guys. Two quick questions if I may. So as you strengthen your operating relationship with Vodafone, can you get all the benefits that there are to extract from that relationship just with this kind of a partnership? Or would there be merits to potentially thinking about combining these companies at some point in the future?
Secondly, just going back to the smartphone question for a second, it looks like your share of the smartphone market is coming in a little weaker than we expected. I am wondering how much you think AT&T offering a $50 iPhone dampened your capture of the smartphone market?

It sounds like you think with the launch of an iPhone 5 and a strong lineup of devices in the fourth quarter you should really see your smartphone share accelerate. I just want to see if -- make sure that that is what you expect. Thanks.

Lowell McAdam - Verizon Communications, Inc. - President, COO

Okay, so there is a lot in there too, Jonathan. I don't have a lot more to say on the smartphone versus what I said earlier. I do think it is about a quarter behind what we had talked about in January. So given the delay of the iPhone 5 is more than a quarter, I think we have actually performed quite well.

AT&T is a strong competitor, and they have done a lot of things to be a strong competitor. But I like porting ratios. I like our growth rate versus theirs. So I think what you are seeing is a result of a very dynamic market.

Regarding Vodafone, look, I don't see a combination here. I think that we can do what we need to do in our markets; they can do what they need to do in their markets; we can leverage each other's scale. But I would not send any kind of messages here that something like that is immediately on the horizon.

I think we need to show that we can do a good operating partnership here. Vittorio and I see a ton of opportunities in that particular area, and we will cross whatever bridges are ahead of us when we get to them.

Jonathan Chaplin - Credit Suisse - Analyst

Great. Thanks very much.

John Doherty - Verizon Communications, Inc. - SVP, IR

Thanks, Jonathan. Brad, we have time for one more question please.

Operator

James Ratcliffe, Barclays Capital.

James Ratcliffe - Barclays Capital - Analyst

Morning, folks. Thanks are taking the questions; and Lowell, congratulations again.

Lowell McAdam - Verizon Communications, Inc. - President, COO

Thanks, James.

James Ratcliffe - Barclays Capital - Analyst

Two quick, if I could. One on Wireless. Are you expecting to see any churn impact from launching usage-based pricing as customers become loath to give that up by moving to another carrier?
Secondly, can you talk through a little bit about what margin impact you are seeing from the growth of FiOS? Both leveraging the existing infrastructure with greater revenue, and offsetting the higher operating costs associated with a larger portion of revenue coming from video. Thanks.

**Lowell McAdam - Verizon Communications, Inc. - President, COO**

Great, James. Let me take the question on tiered pricing and then Fran can come back and talk about the margins. In my view is that tiered pricing is like gravity. The industry has to get there because there is not unlimited spectrum.

When you look at the utility of the devices that we offer and the video demand that is going to be hitting the devices, it is inevitable. Now each carrier will be in a slightly different position because of their spectrum holdings and their capacity on their networks. So I think over time there may be some that hold out longer with unlimited; and I wouldn’t be surprised if unlimited comes back in and out from a promotional perspective for carriers to balance growth.

But in my view, it is, as I said -- like it’s inevitable. So do I expect to see some churn impacts? Sure.

There will be some users that are very high users that will want to move between carriers to find whatever opportunity they can to continue that. But our strength has always been the best network and the best customer service. And at 2 gigs, well over 95% of our customers are underneath that demand; so I don’t think there will be tremendous disruption.

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

Okay, and then James, on the FiOS margin, what I will say, this -- is we continue to make improvements operationally in the FiOS whether it be on the capital cost of passing a home and a capital cost of connecting the home. And then operationally we are still performing very, very well compared to core, especially around repair and maintenance because the FiOS network operates pretty efficiently.

So, I think overall what I will disclose is that FiOS margins continue to improve. I think it is based on two things.

One is we are very concentrated on the top-line growth of our revenue per customer. We have launched FlexView. We have rebundled where you can build your own bundle now, and we are seeing some nice uptick in people varying whether they want higher speed or less bundling in TV packages. And now also with our forthcoming release of our connected home product around security and energy monitoring and electricity and all.

So I think it is twofold. It is the operational cost efficiency and building the top-line growth of FiOS.

**James Ratcliffe - Barclays Capital - Analyst**

Great. Thank you very much.

**John Doherty - Verizon Communications, Inc. - SVP, IR**

Thanks, James. Thanks to all of you for joining us this morning. Brad, that concludes our call.

**Operator**

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