OVERVIEW:
VZ reported 2012 EPS (adjusted for non-operational charges) of $2.24 and 4Q12 GAAP loss per share of $1.48.
CORPORATE PARTICIPANTS

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Fran Shammo  Verizon Communications Inc. - EVP, CFO

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PRESENTATION

Operator

Good morning, and welcome to the Verizon fourth-quarter 2012 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.

John Doherty  Verizon Communications Inc. - SVP of IR

Thanks, Brad. Good morning, and welcome to our fourth-quarter 2012 earnings conference call. Thanks for joining us this morning. I am John Doherty. With me this morning is our Chief Financial Officer, Fran Shammo, as well as Mike Stefanski, who recently assumed my role as Head of Investor Relations.

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. Replays and a transcript of this call will be available on our website later today.

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 also 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 also available on our website. I’d also point out that 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 takes you through the details of our results, I’d like to cover the differences between reported and adjusted earnings this quarter. These are displayed on slide three. For the quarter, we reported a loss of $1.48 per share on a GAAP basis. This quarter, there are several significant nonoperational charges that I would like to highlight. The largest item is a pretax charge of $7.2 billion related primarily to the non-cash, year-end...
mark-to-market adjustment of pension and OPEB liabilities. This charge is due primarily to changes in the discount rate and other actuarial assumptions, as well as the annuitization of various pension liabilities during the quarter. On an after-tax basis, this charge amounted to $4.4 billion, or $1.55 per share.

We also incurred pretax charges of $1.4 billion related to early retirement of debt and other restructuring activities. Most of the charges are debt redemption costs resulting from a tender offer for a high coupon note during the quarter. On an after-tax basis, this charge was $871 million or $0.31 per share. By excluding $1.86 per share for these nonoperational charges, adjusted EPS for the fourth quarter was $0.38. This adjusted result includes $319 million of direct impact from Superstorm Sandy which equates to $0.07 per share. Excluding the Sandy impacts, adjusted EPS would have been $0.45 for the fourth quarter, and full-year results on the same basis would have been $2.31 per share.

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

Fran Shammo - Verizon Communications Inc. - EVP, CFO

Thanks, John. Good morning, everyone, and happy new year. Before we get into the details, let me start with some overview comments to put our fourth-quarter and 2012 results in context.

As we have outlined in the past, our strategy is to build upon the strong foundation of our superior network assets as platforms for growth and innovation. This positions us in the center of the trends that are driving growth in our industry. We have been consistently focused on better leveraging our capabilities across all parts of the business to capture growth opportunities in three key areas.

In Wireless, we are looking to take advantage of opportunities driven by the rapid evolution of 4G LTE. Another key area is FiOS, where we are looking to further penetrate the consumer and small business markets. We are also looking to drive growth in enterprise strategic services, particularly in the areas of global IP, cloud computing, security and managed services.

From a financial standpoint, our focus is on execution, capturing incremental revenue and driving operating efficiencies throughout the business, increasing our cash flow and improving our earnings profile. During the year, we made good progress across the entire business, which I will detail more in the segment reviews.

In addition to our solid execution, we also continued to make smart investments for future growth and improved profitability. While very disciplined in our approach to capital spending, we continued to invest in networks and new technologies which will be the platforms for accelerated growth going forward.

On the strategic front, we closed several key transactions that will significantly improve our competitive position, namely the acquisition of additional spectrum, the purchase of Hughes Telematics, the creation of Redbox Instant by Verizon, our continued investment in Verizon Digital Media Services and the annuitization of $7.5 billion of pension obligations. We are also focused on joint efforts around innovation with a number of partners, and we expect to continue to build on our leadership position in the rapid development of the 4G LTE ecosystem.

From a shareholder value perspective, we generated a total return of 13.2% in 2012 through a combination of stock price appreciation and dividends. For the sixth consecutive year, our Board of Directors approved a dividend increase, indicating their confidence in the sustainability of our business model, cash flows and improved earnings profile in 2013 and beyond.

Let's begin with a brief look at consolidated results, starting with slide five. Revenues from strategic growth areas drove a $5 billion improvement in our top line in 2012, and increased our annual growth rate by 50 basis points to 4.5%. In the fourth quarter, consolidated revenue growth increased to 5.7%, which was our highest quarterly growth of the year. Our positive momentum in Wireless and FiOS, together with our continued focus on improving the revenue mix in our enterprise business, gives us confidence that we can drive top-line growth in 2013.

Let's take a closer look at earnings on slide six. Our strong focus on cost management and improving profitability resulted in double-digit growth in adjusted operating income for the year. Through the first nine months, we posted double-digit adjusted earnings growth.
In the fourth quarter, our bottom-line results were impacted by a decision to take advantage of our strong wireless market position, which enabled historic customer growth and smartphone penetration gains. Additionally, the significant challenges created by Superstorm Sandy certainly had an impact on the business in the fourth quarter. As a result, 2012 earnings per share, adjusted for the nonoperational charges John outlined earlier, came to $2.24.

One additional comment I would make related to Sandy is that while we were able to specifically identify a direct impact to the Wireline business in the fourth quarter, it was extremely difficult to effectively quantify the actual impact to normal operations. I will talk more about this later.

Now let’s move into a review of the segments, starting with Wireless on slide seven. As one of our key growth platforms, we have consistently invested in Wireless to differentiate ourselves in terms of network quality, reliability and the overall customer experience. Five years ago, we made a bold commitment to 4G LTE as the next-generation technology. Since then, we have invested in the technology and its deployment. We secured valuable spectrum, we fostered a robust device ecosystem, and this past year, we introduced shared data plans that changed the industry's pricing framework.

These actions have resulted in consistent sequential growth throughout 2012. Coming off a strong third quarter, we made a strategic decision to take advantage of our 4G LTE lead and invest in growth, which resulted in a record high postpaid gross and net adds in the quarter. In his keynote address at CES a few weeks ago, Lowell showcased our long-term vision of what is possible with the 4G LTE, highlighting innovation applications under development in areas like video, the connected environment, healthcare and energy. Our new brand advertising campaign with the theme Powerful Answers demonstrates our vision of network innovation and the many growth opportunities which will expand the industry in the coming years.

In 2012, Wireless operating revenues totaled $75.9 billion, up 8.1%. Wireless now represents more than 65% of Verizon’s consolidated revenue.

Service revenue increased $4.6 billion or 7.7% for the year, driven by connections growth and increasing smartphone penetration. This service revenue growth, together with our intense focus on cost efficiency and our ability to retain customers, is clearly helping to mitigate equipment cost pressures. Our success in capturing these cost savings resulted in higher profitability growth in 2012.

EBITDA grew $3.2 billion, or 12.2% for the year, and we expanded our industry-leading EBITDA service margins by 180 basis points to 46.6%.

Let’s now turn to a more detailed look at volume growth, beginning on slide eight. Throughout 2012, we saw accelerating sequential growth in the postpaid market, culminating in record net adds in the fourth quarter. We had a great year of postpaid connections growth, enabling us to gain market share. Postpaid gross additions were up 6%, and postpaid net adds increased by almost 800,000 to 5 million, our highest annual net add total in four years.

During the fourth quarter, we added more than 2.2 million new retail connections, with 2.1 million postpaid and 142,000 prepaid. We have an industry-leading 98.2 million retail connections, with 92.5 million postpaid and 5.7 million prepaid. Our postpaid connections represent 35.1 million accounts.

Within the postpaid net add mix this quarter, 1.9 million were smartphones and about 600,000 were Internet devices; the remainder being the net change in basic phones. Postpaid gross adds in the quarter were a record 4.7 million, up 18% sequentially and 29% year-over-year. In terms of upgrades, 9% of our postpaid connections base upgraded during the quarter, up from around 7% in the third quarter and less than the 10% we experienced a year ago. Our churn metrics continue to be market-leading. Retail postpaid churn was 0.95%.

Next, let’s turn to slide nine and take a look at device sales and our progress in 4G LTE. Our record sales volumes in the fourth quarter included 12.5 million postpaid devices, more than 90% of which were smartphones. As we’ve seen each quarter, an increasing majority of these phone sales were smartphones. In the fourth quarter, we activated 9.8 million smartphones, which was by far our highest total ever. About 65% of these smartphones were 4G LTE. In terms of Apple iPhones, we activated about 6.2 million in the quarter and almost half were 4G LTE. Android phones made up a majority of the remaining smartphones, and over 95% were 4G LTE. Our smartphone penetration increased from 53% last quarter to 58%. A year ago, smartphone penetration was 44%.
A key point of differentiation for us, which speaks to our incremental revenue opportunity, is the improved mix of gross adds and upgrades within our smartphone activations. In the fourth quarter, gross adds or new to Verizon represented about 30% of total smartphone activations, a sharp improvement from the 20% to 23% range we reported throughout 2011 and the first half of 2012.

We also have incremental revenue potential within our upgrades, as about 42% of customers upgrading this quarter were buying a smartphone for the first time. In addition, if we include customers upgrading from a 3G to a 4G LTE smartphone, considering the likelihood of higher data usage, we can say that three out of four upgrades represent incremental revenue going into 2013.

Customer adoption of 4G LTE is really gaining momentum. While we have seen a steady increase in sales of 4G LTE devices each quarter since we launched service, the sequential increase in the fourth quarter was much more dramatic. Total 4G LTE device sales increased to 7.3 million, up 60% from the third quarter. Smartphone activations represented 6.4 million of this total, up 74% sequentially. Virtually all Internet device sales in the quarter were 4G LTE, with tablet sales doubling over the third quarter.

At the end of the year, 4G LTE phones and devices represented 23.3% of total retail postpaid connections. 34% of our smartphones and 58% of our Internet devices are now 4G LTE. Almost half of our total data traffic is on the 4G LTE network, which we believe is five times more efficient than 3G. As we have stated throughout the year, we are no longer adding capacity to our 3G network. While the 4G LTE connections and data volumes are impressive, we expect that these percentages will continue to grow, as all new smartphones in our device roadmap will be 4G LTE.

In terms of 4G LTE geographic coverage, we are by far the market leader. Our 4G LTE service is currently available in 476 markets covering more than 273 million POPs, or about 89% of the US population. We intend to continue leveraging our advantage and expanding coverage, with the goal of having a nationwide 4G LTE footprint similar to our 3G network by midyear 2013.

Let’s take a closer look at our quarterly revenue performance on slide 10. Total Wireless revenues grew 9.5% to $20 billion in the fourth quarter. Service revenue grew 8.5% in the fourth quarter, driven by equally strong retail service revenue growth. As you know, last quarter, we began disclosing new retail postpaid metrics, replacing ARPU with ARPA, as well as providing the number of postpaid accounts and the average connections per account.

During the quarter, ARPA grew to more than $146 per month, an increase of 6.6%. The average connections per account increased to 2.64, up more than 4%. In just six months, 23% of our postpaid accounts are on a Shared Everything plan. Customers are quickly recognizing the value proposition. Adoption is ahead of our expectations, and we continue to see customers adding devices to their plans and increasing their usage tiers.

Let’s conclude our Wireless review on slide 11. Our EBITDA service margin of 41.4% in the quarter was impacted by higher retail gross adds and the increased mix of smartphone sales this quarter, in addition to stronger indirect channel performance. During the fourth quarter, we activated 2 million more smartphones than we did a year ago and saw only an 80 basis point differential in the margin. In terms of absolute dollars, we generated $6.8 billion of EBITDA in the quarter, which is an increase of 6.3% year-over-year.

This strong customer growth and increased smartphone penetration drove service revenue and increased ARPA. Our intense focus on cost efficiency is helping to mitigate the cost of equipment subsidies and commissions. Our industry-leading customer retention is also a key factor in our profitability, which is a testament to the quality and reliability of our network and to the overall customer experience.

Verizon Wireless continues to be the industry leader, and we have great momentum heading into 2013. We fully expect to sustain our very strong service revenue growth and increase our profitability this year. Last year, we saw margins recover quickly from heavy smartphone sales in the fourth quarter of 2011. In 2013, we expect Wireless EBITDA margins will rebound within the range of the record levels we reported in the second and third quarter of 2012.

Let’s move next to our Wireline segment, starting on slide 12. In Wireline, we are focused on migrating customers to fiber assets, which provide better services and capabilities, such as FiOS, IP-based applications and cloud solutions. These services are also more efficient and, in the long run, improve our cost structure. The Wireline business made positive strides in 2012 and fundamentals are improving in the strategic growth areas.
From a top-line perspective, we have encouraging signs in the consumer market, where we posted the strongest top-line growth in 10 years. In enterprise, we continue to manage through the secular and global economic challenges. Our product rationalization initiatives are also putting near-term pressure on revenue growth, but we are confident that these initiatives, which include significant efforts in the area of process and systems streamlining, will prove to be the right decision as we build a fundamentally stronger business.

In terms of profitability, we did not see the margin improvement we were expecting in the second half of 2012 due primarily to the length of the time it took to reach an agreement with our unions and also to the significant business disruption caused by the challenges of Sandy.

Our 2012 EBITDA margin of 21.3% includes $319 million of direct impact from Sandy. Again, it was very difficult to effectively quantify the indirect impact caused by this disruption. Sandy had a dramatic effect, particularly on the Wireline business, due to the heavy concentration of damage in the New York metropolitan area. Our challenge was to restore service to customers as quickly as possible, while still managing to meet the demand for new services. We also made a strategic decision to use storm restoration as an opportunity to accelerate fiber migrations in both the enterprise and FiOS markets.

During the course of the year, we successfully migrated 223,000 residential homes to fiber, exceeding our target for 2012. These customer migrations increased in the second half of the year and picked up considerably in the aftermath of Sandy.

From an operational standpoint, we saw an 11% improvement in our overall copper trouble report rate for the year. This marked the first decline in four years and helped to lower the number of dispatches and reduce our repair costs.

Providing these customers with a greater opportunity to purchase a FiOS services is also gaining some traction. For customers that have decided to upgrade to additional FiOS services, we are seeing a $45 lift in monthly ARPU. We are pleased with our progress to date and view the copper-to-fiber migration plan as an important part of our strategy to reduce the Wireline cost structure. In 2013, we are targeting an additional 300,000 homes within the FiOS markets. Let’s take a closer look at the revenue components, starting with Mass Markets on slide 13.

In the fourth quarter, consumer revenue growth of 4.1% was driven by FiOS, where revenue increased nearly 16% and now represents about 68% of consumer revenue. Consumer revenue growth was impacted in the quarter by service credits and customer billing suspensions resulting from Superstorm Sandy. The increasing scale of FiOS is driving growth in consumer ARPU, which increased to more than $105 per month, up 9.5%. FiOS ARPU is now over $150 per month, and two thirds of our FiOS consumer customers are triple play, with voice, Internet and video services.

In terms of broadband customer growth, we had 144,000 new FiOS Internet additions in the quarter, and now have 5.4 million subscribers, representing penetration of 37%. In HSI or DSL, we had a net loss of 117,000 customers. Net broadband subscribers were a positive 27,000, marking an improvement over the past two quarters.

Looking at the full year, broadband revenue growth improved by 3.1%, in spite of the fact that subscriber growth slowed to 1.4%. This revenue growth was driven by customers buying up in speed, taking advantage of our FiOS Quantum offers. I would also attribute some of the improvement to our copper-to-fiber migration initiative. In FiOS video, we added 134,000 subscribers in the quarter, bringing our total to 4.7 million, which is 33% penetration.

Our FiOS customer growth in the fourth quarter was very good. In fact, net adds were greater than the second and third quarters. This was in spite of the significant disruption caused by the Sandy restoral efforts.

In contrast to the second half of 2011, we decided to aggressively meet the increased demand for our FiOS services by authorizing overtime so that we did not lose customers by making them wait until we caught up to the backlog. I would also add that our residential connection trends continue to improve. During the fourth quarter, we lost 156,000 retail residential connections, representing a 6.2% decline year-over-year, compared with a loss of 183,000 or 7.3% at this time last year.

Let’s move to our Enterprise Markets next on slide 14. In the fourth quarter, Global Enterprise revenue declined $83 million or 2.1%, all of which was due to lower CPE sales. Strategic Services, which comprised 54% of global enterprise revenue, totaled $2.1 billion and were up 5.3%. 
During the quarter, we continued to see delays in new contracts and investment decisions as enterprises exercised caution with regard to the fiscal cliff, potential tax reform and other government policy changes. This uncertainty created a wait-and-see approach that clearly impacted new business in 2012. We continue to believe that as these factors evolve, companies will be in a better position to make decisions about their capital commitments. We remain hopeful that enterprises will renew their investing activities in 2013.

Moving next to Global Wholesale, fourth-quarter revenues declined $168 million or 8.7% year-over-year, due primarily to continued declines in transport services. Again, our strategy is to exit unprofitable routes and contracts and better position the business in the fiber-based ethernet data services space as customers with special access transition from DS1s and DS3s.

Let’s conclude our Wireline review on slide 15. In the second half of the year, we saw some improvement in top-line performance. In the fourth quarter, Wireline revenue was down 1.5%, representing an 80 basis point improvement over the rate of decline in the third quarter. Sequentially, revenue increased $76 million, or 0.8%.

In terms of cost, as I said earlier, this was a very challenging quarter and far from normal when you factor in the additional resources devoted to Sandy restoral efforts and to quickly catching up on our FiOS order backlog.

On the labor front, after 400 days of negotiations with our unions, we have a fair and balanced three-year agreement that is good for our employees as well as a positive for the business.

In the Consumer and Mass Markets business, we are confident that several factors will lead to an increasing contribution to Wireline profitability in 2013. These include our focus on driving FiOS revenue growth and improving our operating and capital efficiency, the continued success of our copper-to-fiber migration initiative and the benefits of the new union contracts.

In Enterprise, we still see uncertainty around the debt ceiling, deficit reduction and tax reform. We are all looking at the same published reports about international economic growth, which point to continued pressure on enterprise spending. We believe the actions we are taking will ultimately improve our cost structure and are the right steps toward improving Wireline profitability. In the short term, we expect similar performance within our Enterprise unit. If some of the uncertainty is dealt with by Washington, then things can improve throughout 2013.

I would like to turn now to slide 16 to discuss our cash flow results and how we further strengthened our balance sheet in 2012. Our free cash flow in the fourth quarter and full year was once again a combination of strong cash generation and disciplined capital spending. For the year, cash flow from operations grew 5.7% to $31.5 billion and free cash flow increased to $15.3 billion, up 13%.

Capital expenditures for 2012 totaled $16.2 billion, down about $70 million from last year. This includes about $135 million in capital related to Sandy.

Our capital efficiency improved, ending the year at 14%. With the heavier investments to transform our business largely behind us, we would expect our CapEx-to-revenue ratio, which is already at a historical low, to continue to decline, based on disciplined capital spending and sustainable revenue growth.

In Wireless, CapEx in the fourth quarter increased to $2.8 billion, and we finished the year at $8.9 billion, down 1.3%. In 2012, we allocated more capital to 4G LTE to expand coverage. In the fourth quarter, we also pre-positioned additional capacity in certain key markets. As more customers choose 4G LTE smartphones and devices, we expect the continued migration of data traffic from 3G to our lower-cost 4G LTE network will drive further improvements in operating and capital efficiency in 2013 and beyond.

In Wireline, capital spending was $1.7 billion in the quarter, to finish the year at $6.3 billion, down about 1%. Our balance sheet and credit metrics remain very strong. Total debt of $52 billion was down more than $3 billion or 5.7% from the end of last year. We ended the year with a net debt of $48.9 billion, and our net debt to adjusted EBITDA ratio was about 1.3 times.
In December, we closed a pension annuitization transaction with Prudential, transferring $7.5 billion of management retiree pension benefit obligations by purchasing a group annuity contract. This transaction was part of an overall pension de-risking strategy, which will reduce our exposure to funding and income statement volatility caused by changes in investment returns, discount rates and longevity risks.

This transaction also provides us with additional financial flexibility. In the fourth quarter, we contributed an additional $1.7 billion in pension funding to end the year at $3.5 billion, which is in line with what I indicated on our third-quarter call. Again, we do not expect any cash funding requirement for qualified pensions in 2013, and based on our current plan assumptions, we expect contribution requirements in future years to be lower as a result of this transaction.

Let’s move now to our summary slide. We enter 2013 with great confidence in our ability to take advantage of the market opportunities we see in our key strategic growth areas. We have great momentum in Wireless, and we expect to build on that strength, driving further penetration of devices and extending our leadership position in 4G LTE. In FiOS, we expect to drive higher penetration in existing markets and continue to differentiate ourselves with our superior Internet and video services.

In the Enterprise space, we will continue to aggressively market our Strategic Services, demonstrating to customers that we have a unique set of capabilities to combine solutions around the network, data center, security and cloud infrastructure.

In terms of our cost structure, we will continue to drive operating efficiencies across and throughout the entire business. We continue to dedicate resources to examine all costs and processes, including product rationalization, service provisioning, back-office operations and systems. Our ability to effectively execute and capture these incremental revenue opportunities and operating efficiencies will result in increased profitability, higher cash flows and improved earnings growth in 2013 and beyond.

Lowell and I have challenged our business leaders to build on the strong foundation we have, accelerate the momentum we’ve achieved, improve our investment returns and drive significant shareholder value. With that, I will now turn the call back to John so we can address your questions.

John Doherty - Verizon Communications Inc. - SVP of IR

Thanks, Fran. Brad, let’s open it up for our first question, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Jason Armstrong, Goldman Sachs.

Jason Armstrong - Goldman Sachs - Analyst

Thanks, and good morning. Fran, maybe quick question on Wireless margins and maybe just a clarification on your outlook comments. I think you said you can get back to margins that we saw in the second and third quarter of this year, which was in the 49% to 50% range. Was that a full-year comment or was that a 2Q and 3Q of 2013 comment? And if it is full-year, that is 200 to 300 basis points in margin expansion in Wireless. Just help us think through the drivers of that.

And then second, on capital spending, we’ve heard three of the industry peers in Wireless talk about an upwards bias to CapEx as we head into 2013. At the same time, you are winding down the initial LTE build and talking about decline in capital intensity. Just help us think through maybe your confidence in the ability to sustain network leadership position in Wireless, given that. Thanks.
Fran Shammo - Verizon Communications Inc. - EVP, CFO

Good morning, Jason. Thanks for the question. So on the Verizon Wireless margins, that was a view of a full-year range. And I think if you look at just the fundamentals of the business, I would say that our fundamentals are more sound than they were a year ago.

If you look at this business, it grew EBITDA $3.2 billion, or 12%, and that was with a historical growth rate in the fourth quarter of this year. We gained significant market share that we will carry us into next year with 5 million net adds. If you look at our ARPA growth, our ARPA growth was over $9 from a year ago, and that is on a base of 35 million accounts. So the fundamentals of this business are extremely strong, and I have no doubt that we will return to a margin progression of where we left the second and third quarter.

On the CapEx side of the house, the guidance I would give for 2013 is no different than what I've said before, which is we will be flat. That is in addition with all of the 4G LTE continued buildout that we have.

I would tell you that we ended this year slightly higher than we probably had expected in midyear, but there were two factors for that. Number one, Hurricane Sandy or Superstorm Sandy created us to incur $135 million of additional Wireline capital. But in addition, we also proactively spent another $300 million on the Wireless side to preposition our AWS spectrum that we originally planned for 2013, and we advanced that into 2012.

And that was because we were coming off such a strong third quarter, and we knew that by investing in the growth for the fourth quarter that we were going to need to preposition this. So in essence, we've actually forward-advanced some '13 capital. So I am very confident that we will not end up where some others will be and that our CapEx will be flat for 2013. Thanks for the question, Jason.

Operator

Phil Cusick, JPMorgan.

Phil Cusick - JPMorgan - Analyst

First, to follow up a little bit on Jason. On the Wireless side, can you help us sort of break into that 49% to 50%? Last year, you talked about a sort of $2 billion cost-cutting effort. Can you help us quantify that? And then second, as that leads into earnings per share growth, can you help us with a range of what EPS growth should be this year? It seems like a real acceleration is possible.

Fran Shammo - Verizon Communications Inc. - EVP, CFO

Thanks, Phil. Good questions. So, first on the 49% to 50%, as you know, over the last three years, we’ve taken $5 billion worth of cost structure out of Wireless. We have another $2 billion of target for this year, and we already have all of those initiatives established for the $2 billion. Now, that will happen over the course of the year. So we will continue on that.

In addition, we've also launched our Verizon Lean Six Sigma, which will also contribute to the reduction of the cost structure within Wireless. But also, I would extend that that as we consolidate -- and I'll use finance as an example -- as we consolidate the finance organization to the middle, we will actually take cost structure out of Wireless, but we will also implement Verizon Lean Six Sigma around the entire organization and reduce the full cost of finance across the board. So again, some of the corporate Verizon Lean Six Sigma will also help reduce the cost structures of the individual units, including Wireless and Wireline.

As far as EPS guidance, I’m not going to give specific guidance today. But what I would tell you is that if you look at the first three quarters of 2012, our approximate growth was 15% year over year. And, as I said, I am more confident in the fundamentals of this business today than I actually was a year ago, so that should give you some sense of my confidence for 2013.
Phil Cusick - JPMorgan - Analyst

Great. Thanks, Fran.

Operator

John Hodulik, UBS.

John Hodulik - UBS - Analyst

Maybe two, if I could. First, Fran, you’ve given some good guidance on the Wireless margins and some of the consolidated. Maybe a little bit on Wireline. You are going through this VES repositioning. Can you talk about the progress there and maybe give us a sense for what kind of Wireline margin improvement we could see on a year-over-year basis?

And then secondly, with the CapEx intensity coming down and some of the stuff you’ve done to derisk the pension, we’ve talked a little bit about buybacks and -- maybe becoming part of the discussion by the end of the year. How do you feel about it given what you’ve seen here in 2012?

Fran Shammo - Verizon Communications Inc. - EVP, CFO

Thanks, John. On Wireline, first, I guess I want to take a few minutes on this one, because obviously there are two separate components to this. One is the Consumer side, and then one is the Enterprise side. So let’s start with the Consumer.

Obviously, for the fourth quarter, Consumer and Wireline was significantly impacted by Sandy. And as I said on my opening remarks, it was almost impossible for us to really calculate up the impact that that had.

But putting that aside, I think the strength of the platforms that we have built on will continue to drive the profit of Wireline. So first, copper-to-FiOS migrations, we completed 223,000 this year. Our target is 300,000 next year. This is significantly reducing the cost structure of Wireline from a repair perspective. And as I said in my opening remarks, 11% reduction of the first time in repair load from truck roll. So our strategy is working.

Then we talk about the strategic pricing around FiOS. And I said a year ago that we were not disciplined around our price-ups. And we started that in 2012, and as I said coming out of the third quarter, we already had our strategy laid out for 2013. So that strategy will continue to help offset the content cost increase.

In addition, FiOS Quantum, if you look at what we’ve done over this last year, we’ve really solidified the strategy around speed. And what we are seeing, as customers migrate from that copper and even current customers are buying up in the speeds, because they realize the quality products that we have.

Then if you go and look at just the union agreements and some of the pension things we did, this all culminates on the Consumer side.

Now, having said that, there are other things that we are investing in that put a little pressure on the Wireline margins. So for instance, Redbox; Redbox was a startup this year. We incurred startup costs like any startup company would. That put pressure on us in the back half of this year.

Hughes, we acquired Hughes; it was a loss company. We are building that company. They are doing an excellent job on acquiring contracts. We have one that we signed recently that will launch in the second, third quarter of this year. So we are actually adding 200 to 250 people in that business to get ready for that new auto company that we signed this agreement with in telematics. So again, continuing to grow on that platform.

VDMS is also another startup that we incurred some operating expense with no associated revenue.
So when you look at Redbox, Hughes and VDMS, these will all start to contribute to top line in Wireline for 2013. But again, probably not much in the profit area, because they are all startups, and I would think that in 2014, these will really start to contribute to the overall profit.

On the Verizon Enterprise side, obviously, my view on this one is the best that we can hope for is flat at this time because of all the uncertainty. Now, as I said in my opening remarks, if we can get rid of some of the uncertainty around debt ceiling and deficit reduction and especially tax reform, I think this will open up for companies to start investing again. But given that, in this time of repair, we are actually building out the platforms with Terremark, and again, Hughes and Verizon Digital Media Services.

So I think we are making all the right strategic moves around the product rationalization. So having all this combined, I am confident that we can improve our profit in Wireline 2013 over 2012.

Now on the share buyback, given everything that we have done this year, I think we are exiting this year with a really strong balance sheet. We executed on our pension annuitization. We've declined our debt by over $3 billion. We also strengthened our balance sheet from another -- of other means, as well.

So when you take this all in culmination and the strong cash flow performance on a year-over-year basis, even with the growth that we did in the fourth quarter and the impact of Sandy, I originally stated that share buyback would be something that we would do at the end of 2013. I am in a position now that we could do share buybacks at any point in time right now, but I would call it an opportunistic time. So if the opportunity presents itself in our share price, then I would contemplate buying back shares. So hopefully, that answers the question, John.
On the cash taxes, as I've said before, this community kept questioning me about the increase in my cash tax in 2013, and I kept telling everyone that we had plans in place that even with bonus depreciation going away, that would not happen. Now with bonus depreciation there, that is why I've reflected back to the share buyback and why we are in a different position here.

So I think that all ties together. But our effective tax rate for going into next year would be the same as the guidance I gave this past year, which is anywhere from 31% to 33%.

Simon Flannery - Morgan Stanley - Analyst

Great. Helpful. Thank you.

Operator

Michael Rollins, Citi Investment.

Michael Rollins - Citi Investment - Analyst

Thanks. Good morning. A couple questions. First, just the typical Verizon Wireless net debt question, if we could just get an update on that balance at the end of the year.

And then secondly, as you think about the Wireless margin guidance that you laid out for 2013, can you talk a little bit more about what is going on with the device replacement rate, which can add some sensitivity to the margins? Do you think that will be a faster rate of replacement, same, or even lower in 2013? If you could talk about some of the drivers that are contributing to that. Thanks.

Fran Shammo - Verizon Communications Inc. - EVP, CFO

Thanks, Mike. So on the net debt side of the house, Verizon Wireless is $9.3 billion net debt. They actually have about $1.4 billion worth of debt maturing in 2013, which we at this point plan to retire.

Just on the overall handsets, this really goes, I think, to the question of the upgrade rate and what do we see. And again, as we saw this year, as I said, we would see an uptick in upgrades going into the fourth quarter from the third quarter, but we would be down from a year ago, and that is exactly what happened.

I would say that 2013 is probably a flat year on an upgrade basis to this year, so I don't see any incremental increase. But it is the quality of the upgrades that we are really focused in on. And if you look at the progress of basic phones, this year, we had a significant amount of basic phone upgrades. So if you look at a year ago, a year ago we moved about -- in the fourth quarter -- 3.5 million basic phones. That was cut by 50% this year.

But what we are seeing is as the prices of the smartphones have decreased, there is an incremental population that are coming into that smartphone category. And again, every single one of these adds and every single one of these upgrades, except for a few who are willing to pay full price for the smartphone, are moving into our shared price plan. And as I said, 23% of our accounts now are on shared pricing, and you can see what's happening from a revenue increase perspective and a device attachment perspective.

So again, I think that from a pure upgrade perspective, it is flat, but the quality of upgrades, I think, just continues to get better into 2013.
Fran, not to beat a dead horse here on the full-year guide, but I'm assuming you are anticipating an iPhone refresh at some point in time. And then just thinking about as we look forward over the next -- whatever -- year or so, smartphone penetration obviously getting close to 60% now. How do we start to offset the impact of this smart-to-smart migration on margins generally? And I know you talked about 4G driving some additional revenue opportunity there. But how should we think about the margins longer term as we get smartphone penetration reaching just call it 80%, and then we're seeing much more of this sort of smart-to-smart impact?

Fran Shammo - Verizon Communications Inc. - EVP, CFO
Thanks, Mike. I guess the way I look at this is that there is more to this than just the smartphone category. So if you look at -- again, of what we are doing with shared, and the increase of the revenue and the attachment of other devices. So if you look at our Internet device category, including the tablets, we had one of our strongest quarters from any other device attachment rate than we've had in the past. This all drives the revenue.

So when you think about the increase in the service revenue side -- because this does not go with just concentrating on the subsidy of the handset -- because the subsidy of the handset, although higher than a basic phone would be, these drive incremental revenues from a usage perspective. And especially when you have a platform like the LTE, with the speeds and the video consumption that people are using and the buying up of the tiers that they have. And then you think about machine-to-machine and the opportunities for mobile payments and other solutions that are going to ride off of the Hughes platform, we have many, many opportunities to offset the subsidy with the incremental revenue.

Now having said that, on the subsidy side of the house, you can see that the price of the handsets continued to decline. We now have the Windows platform in our mix, and we saw some steady, albeit slow, increase in some of the uptake of that platform. But as we get more and more platforms in the mix -- and now we have RIM out there again -- there is going to the incremental competition, there will be subsidy reduction, as there was in the basic phone history in the ecosystem.

So again, this is full management of the P&L. This is just not locking in on one item on the P&L. And if you culminate that with the $5 billion reduction in cost and the other $2 billion that we have this year, again, I am very, very confident in the fundamentals and the trajectory that we have going into 2013.

Mike McCormack - Nomura Securities - Analyst
Okay. Fran, what was the initial impact on the pooled data plans? I know you guys had anticipated some potential risk of dilution there. What was the initial experience for those that are signing up?

Fran Shammo - Verizon Communications Inc. - EVP, CFO
Yes --
Mike, can you just -- I think we missed the front end of that question. Could you just restate it, please?

Just the pooled data plans, I know you guys had talked initially about some potential early dilution when you switched over to those plans. Just trying to get a sense for what the early experience has been.

The early adopters, obviously, were in fact dilutive, but it wasn't as much as we had expected. And if you look at the ARPA growth that we are generating now, it actually is way offsetting any of that initial dilution. So we are in a very good place with the shared price plan.

Great. Thanks, guys.

Kevin Smithen, Macquarie.

Can you discuss how you evaluate various uses of free cash flow? With spectrum purchases last year, CapEx flat and tackling the pension, it looks like you were going to have a lot more free cash flow this year. You've talked about the buyback, but you've also mentioned some cloud, video, Wireline growth initiatives, potentially raising the dividend. Or would you save powder for Vodafone or other Wireless M&A? How do you balance all those out, and should we think about a little bit of all of them or focus on the buyback, given where the stock is right now?

Kevin, I think you answered the question, all-encompassing in your answer. But, look, I think it is all of the above. Again, I think we left this year in a very, very good, solid place. We bought spectrum last year. We bought Hughes last year. We made some significant investments. We continue to invest in that Redbox platform, the Hughes platform, as we acquired it. We continue to build out the Terremark asset that we acquired over a year and a half ago.

So it is all of the above. And share buyback, dividend policy, deleveraging is all encompassed in that strategy. So again, I think you answered the question given everything you said.

Operator

Tom Seitz, Jefferies.
Tom Seitz - Jefferies - Analyst

One on Wireline and one on Wireless, if I could. On Wireline, can you help us think about the impact to Wireline margins of the copper migration over time? Texas is one of the oldest FiOS markets, and I believe you’ve said in the past that video and Internet penetrations there are in the high 40% range. You already had the more favorable union contract down there, more forward-looking state regulatory environment. Are margins in Texas better by a few basis points, or are they on order of magnitude better? Any sort of framing you could do in that area would be great.

And then on the Wireless side, BlackBerry 10 launches this quarter; you just mentioned it. It is reported to be another expensive device. When you look at your BlackBerry base, is there any chance at all that this handset has an unusual impact to the first-quarter or second-quarter margin that could impede the improvement you outlined?

And if you can indulge me, any view your product guys have on RIM becoming the third competitive OS, now that they’ve seen the device?

Fran Shammo - Verizon Communications Inc. - EVP, CFO

So on the Texas market, I am not going to specifically speak to any individual market of FiOS. It is not a good thing for me to do that at this point in time. But what I would tell you is it is the highest penetration of our market. It is a very profitable market. So given where we are in Texas, which was the first market we launched, we know that the rest of the markets can achieve those types of penetration rates, which were in the 50%. So there is no stopping us from a penetration rate.

And as we continue, and you saw this quarter, we had higher demand for the FiOS product. And some of that was because, quite honestly, Superstorm Sandy showed the reliability of the fiber network even in this type of a catastrophe. Copper does not mix with water. Fiber optics doesn’t care if it is in water. So again, the strength of how we build our reliable network with generator backup and all sorts of things just speaks to the popularity of this product.

So I think we are in a good position going into 2013 overall with FiOS. And I will tell you that year over year, FiOS continues to become more of a profitable product for us. So I’ll answer it that way.

On the BlackBerry 10 launch, given your question, no, I don’t anticipate any unusual item that would cause me to come off of the statement I made earlier. This is just yet another platform. We are hoping that the platform is successful. We have very loyal BlackBerry users in our base, and we will see how that goes. But all in, we now have four operating platforms coming into the mix, and again, as I said before, I think more choice for our customers is better for us and for the consumer and for competition.

Operator

David Barden, Bank of America.

David Barden - BofA Merrill Lynch - Analyst

Thanks very much. Welcome, Mike. Just wanted to ask two, if I could. Number one, Fran, on the ARPA growth that you saw, could you kind of give us a sense as to the mix of the drivers in the growth year-over-year? Is it the volume coming from the tablets, connected devices and people coming from handsets to smartphones? Or with respect to the upgrade in the data plans, has that kind of become a driver that you can quantify and grab onto yet?

And then I guess the second question would be, as you have talked about kind of starting to harvest the 3G network capacity, could you talk about how aggressive you plan on being in terms of trying to monetize the capacity that you have as customers move from 3G to 4G? I would imagine that there is a lot of opportunity to especially get more aggressive in the prepaid side of the equation. Thanks.
Fran Shammo - Verizon Communications Inc. - EVP, CFO

Thanks, David. On the ARPA growth, it is a combination of a lot of things. Obviously, it is the -- as we said, based on our view of when we launched this plan, we expected the uptake in the data consumption, based on the LTE network and the speeds that network can deliver. So as people consume more, they will buy up in the tiers.

And then in addition, it is the device attachment. And this one is really considerable for us, because that is why we developed the plan we did, and you can attach up to 10 devices. And what we are seeing is, as we said in the outset here, 30% of these customers coming to us on smartphones are new to Verizon. And what we see is is that they come in at the low end of the devices onto the shared price plan, and over a period of six months, they almost double the amount of devices that they put on the plan.

So the device attachment -- whether it is a tablet or a MiFi card, we launched a camera in the fourth quarter -- so all these things will contribute to the attachment, which will drive usage and then hence drives the ARPA increase.

And then on the 3G network, yes, we stopped investing in that network. We obviously continued to sell the 3G iPhones on that network, which were very successful in the fourth quarter. So again, we manage this network very closely. But look, we made some moves in 2012 around prepaid, and we will see where we go in 2013. But we will continue to utilize that network to contribute to the bottom line of the Company.

David Barden - BofA Merrill Lynch - Analyst

Thanks, Fran.

Operator

Jennifer Fritzsche, Wells Fargo.

Jennifer Fritzsche - Wells Fargo - Analyst

Just following up on David's question on the capacity, on the LTE coverage, given it is almost complete, when will we see you adding more LTE capacity kind of through the lighting up of SpectrumCo, AWS spectrum that you got from the cable companies? And if you (multiple speakers) --

Fran Shammo - Verizon Communications Inc. - EVP, CFO

Thank you, Jennifer. We actually did pre-position -- as I said, this year, we pre-positioned $300 million of capital to start positioning that AWS spectrum for capacity around LTE in some of the major markets. And that really was a result of our exiting the third quarter and the growth that we saw and knowing that we were strategically going into and investing in the growth of the fourth quarter.

So given all of that, we did pre-position the AWS spectrum and we will continue to do that as needed. So we are in a very good position with our LTE network. We are in a very good position with our license holdings, so no issues at this point.

Jennifer Fritzsche - Wells Fargo - Analyst

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

Okay, so thank you, everyone. Let me just close this real quick. First, just thank you for joining the call today. But also, I wanted to just say thank you to John for his diligence here in the IR role, and I wish him luck in his new mergers and acquisitions and business development role here at Verizon. And take the opportunity to welcome Mike Stefanski to the team. So thank you again for joining the call, and look forward to speaking to each of you.

John Doherty - Verizon Communications Inc. - SVP of IR

Thanks, Fran, and Brad, that concludes the 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.