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VZ - Verizon Communications Inc at Deutsche Bank Media, Internet & Telecom Conference

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PRESENTATION

Matt Niknam - *Deutsche Bank - Analyst*

Okay, thank you everyone for joining us. I am Matt Niknam, telecom services analyst here at DB. Welcome to day two of our MIT conference. We are very pleased to have Verizon as our opening keynote. We have CFO, Fran Shammo, with us on stage. Fran, thank you for joining us.

So maybe, Fran, just to kick off obviously a lot is going on with Verizon. Maybe if you can start and talk about your top priorities for the organization.

Fran Shammo - *Verizon Communications Inc. - CFO*

Sure. So I think first let's just start out from just an overall industry segment and this will set up what our priorities are but just from an industry perspective in Wireless, I mean if you look at the Wireless industry I know there is some negativism that it is not going to grow in the future. But as you sit here and you look at this whole environment and if you ever spent time at CES or World Congress, I mean you think about all of everything that is being developed needs a Wireless network to run over it including Wi-Fi but mainly some type of an LTE network. So when you think about the growth opportunities around consumption of video in that environment you think about all of the IoT and smart cities and all the applications that are coming that have to run over a Wireless network, you first look at an industry that says wow, there is still a lot of potential growth in this industry.

Then when you step back and you say okay, Verizon, how do you fit into that overall ecosystem? We really have three main strategic priorities.

The first one is network and the network is still how we build our brand and will continue to be how we build our brand. We will continue to invest very heavily into our network. As you recently saw, we won RootMetrics, we just won J.D. Power across the country so we continue to believe that the network is a differentiator for us moving forward. And we are spending a lot of time in densification, spending a lot of time in small cells in building coverage and that is to handle the user interfaces that we believe will be more important as we get into things like Internet of Things, more of go90 and we can talk more about go90 and video consumption.

The next piece of the strategic initiative is around platforms so our whole belief is that we are developing these platforms and the reason the platform is important so when you think about Verizon's digital media services as a platform, the telematics as a platform, go90 is a solution that sits on top of the platform. But when you look at platforms, these platforms that we are developing can be taken outside the US and so they can ride over any network but we can expand these internationally. So the example I will use is telematics.

We take the telematics platform for Mercedes and we are actually their -- not their connectivity but their telematics solutions provider in China. So we can run these platforms on any one's network and the platform is where some more of the economic value comes from.

And then on top of the platform obviously we want to develop the solutions that can run over these platforms, so go90 is a perfect example of how we develop something that can run over the digital media platform and go90 is something that also can be taken outside the US as far as a solution and licensings and so forth. So our strategic initiative is really to build upon these three different layers within the ecosystem. And I'm sure we will talk about each of them.



Matt Niknam - Deutsche Bank - Analyst

Absolutely we will. Just before we get into the network, platforms and solutions, as you think about investments in these newer areas, you have talked about flattish earnings trends for 2016, several headwinds from the new investments, asset sales, some service revenue pressure that is still ongoing. So can you talk about how Verizon plans on offsetting these headwinds, what progress you might have made to date on the cost containment front?

Fran Shammo - Verizon Communications Inc. - CFO

Yes, look, as you shift the model from an installment or from a subsidy model to an installment sale model, there is mathematics that come into this and so we are at the beginning stages of this because we were the last carrier to really adopt and move in this direction.

So the way you think about this is midyear we should have somewhere around 50% of our customers on that pricing so the math then starts to level out and by the end of 2016 into 2017, you will start to see improvement and then I think by the end of 2017 you will start to see positive service revenue growth again. And that really is just strictly the math of moving from that higher service revenue under subsidy to a lower service revenue and transferring that money over into the installment sale.

So when you talk about headwinds, that is the headwind we talk about. But as we start to invest in some of these startups like a go90, AOL, these are really true startups for us so they create a lot of negative to the bottom line as truly a startup would. And that will continue this year. It will decline next year but there will still be a drag on earnings next year and then three years out will start to turn positive. But even with that what we said was coming out of this year into next year you should see us get back to a GDP topline growth and more of a normal growth at the bottom line.

So as we work through this, it is not only topline; we believe that some of these new ventures that we are going into like go90 monetization on advertising, Internet of Things, the launch of our hum product is going extremely well and that is a recurring revenue stream of \$15 a month from these customers. So there is a lot of things building in the factory that are going to contribute to topline and then that will all transfer to the bottom line over time.

So we are investing for the future and we believe that with these strategic investments we will be able to really truly get back to a growth company here after 2016.

Matt Niknam - Deutsche Bank - Analyst

On Wireless, so smartphones right now are about 95% almost of the postpaid base, the majority of your traffic is now on LTE. So with the competitive environment where it is still very intense, is a lot of the incremental growth in Wireless coming from these platforms and solutions or is there an optimism that traffic will ultimately continue to drive revenue growth?

Fran Shammo - Verizon Communications Inc. - CFO

It is going to be a combination of two. If we look at the smartphone category, look, the smartphone category now is a very saturated category and a lot of the growth that you see in postpaid is really coming from the prepaid side of the house because over time postpaid pricing has come almost cheaper than prepaid was. So you see a combination of more postpaid ads migrating from prepaid to postpaid. And then of course you have the exchange between the carriers that goes on a monthly basis depending upon who is promo-ing, what price-sensitive versus quality and so forth. So that category is going to slow over time.

So the growth is going to come from things like tablets, tablets is still going to be a growth generator for the industry. But even more importantly, it is going to be things like the hum, where there is 150 million vehicles out there today that can plug that adapter into the bottom of their car. And the nice thing about that is they don't need to be a Verizon Wireless customer to do that. They can be on any network to do that.

So we are looking for things that can cross-platform but Internet of Things is absolutely a growth engine for the industry. I mean we have been talking about this but as you go through the ecosystem, everything you see now is going to be connected to some type of a network whether you look at the healthcare industry, energy, all these types of things when you think about telematics and the ecosystem that develops with retailers. So you start to put all this together, there are all kinds of solutions that are going to come to the market place and we are in the process of developing some that you will see later this year like a hum product but in more detail from that.

So Internet of Things will definitely be a growth driver for the industry.

Matt Niknam - *Deutsche Bank - Analyst*

I just want to go back to go90. You talk about a focus on platforms and solutions helping drive the next leg of growth for Verizon. We are about 10 months removed from when the AOL deal was announced so maybe if we can start -- if you can give us an update on how that asset fits with your growth initiatives and the long-term strategy as you look at this next leg of growth that you are trying to build for the business?

Fran Shammo - *Verizon Communications Inc. - CFO*

It goes back, I mean it really goes back about six years ago when we first started to develop our digital media platform which was the concept was a platform that could ingest content, digitally format it without any human touch and deliver it to an end-user. And we are the only ones in the world that have that platform today that can do that from end to end without any human touch through our platform.

So it started with that platform and then we started to build upon that platform and there were two reasons that AOL was very, very appealing to us. One was we needed the ad tech platform, we needed that program advertising platform to insert those ads on a programmatic basis and Tim and his team brought that platform and that expertise. And although there are a lot of platforms out there in the industry, this platform was actually operating and it could scale and that is what attracted us to AOL.

The other thing that AOL brought though was it brought talent and it brought knowledge of the entire video content ecosystem that quite honestly we at Verizon we had but we didn't have it to the level that AOL brought to us. And I mean when you talk to Tim and his team, they understand the ecosystem, they know everyone in the ecosystem and there is a lot of value that was brought to Verizon with all that knowledge. And Tim and his team have integrated very well with the digital media platform. Now Tim actually runs the entire digital media platform and they were the basis for getting the go90 product to launch.

So they are behind that and you're going to see a lot more around go90 this coming year with the cross-pollination between different platforms. So we are starting to integrate to our other platforms that they can utilize and use as a total asset base but we are keeping them very separate from the rest of the corporation because it is a very different culture, it is a very different ecosystem that has to drive that performance.

So I sit here and say that was a great move for us to do that because of the two important things that they brought to the table for us.

Matt Niknam - *Deutsche Bank - Analyst*

And as you think about the forward here, are there areas where you feel like you need more scale to compete more effectively whether it is content, maybe I will say exclusive content, platforms, other ad tech capabilities, what are you sort of looking for as you build this business up the next couple of years?



Fran Shammo - Verizon Communications Inc. - CFO

Look, scale is the key to success in this business. It was the key to success in Wireless, it will be the key to success here. How we get that scale is many different ways. If you look at what AOL has today, they have about 350 million users, viewers on the AOL platform so when we look at go90, it makes sense to cross pollinate go90 to a lot of these other platforms to get that viewership up.

The key here will be the scale of viewers that can come to the platform. That is going to be the success of this platform and that is what we are watching very carefully. So it will be eyeballs and eyeballs will be the winner at the end of the day because they more eyeballs I can get to that platform the more advertisers that are going to come and want to advertise and therefore I can monetize the usage.

So the whole theory behind this which we believe will win at the end is to give all of this content to the Wireless customer for free and we will monetize it in a different way than having them pay for the consumption because the consumption model as I said before, unlimited is a very short-term game in the LTE market. Eventually unlimited is going to have to go away because you have to generate cash to reinvest.

But we also know that the consumer is only going to have so much wallet share per quote communications which Wireless and broadband and cable fall into. So we know that there is a limit so we have to be able to have them consume more but monetize that consumption in another format. And that is how we got to the go90 model and that will be monetized through the advertiser which will then increase revenue and of course contribute to the bottom line.

Matt Niknam - Deutsche Bank - Analyst

On the back of that in terms of competition in Wireless, there has been hope that competitive intensity is moderating. I would argue it is actually potentially gotten worse. AT&T has brought back unlimited, T Mobile and Sprint are fighting with unlimited as their sort of lead promotion. So in terms of your viewpoint in the marketplace, do you think this is evolving now into the new normal as we sort of hit a maturation curve with smartphone and LTE penetration?

Fran Shammo - Verizon Communications Inc. - CFO

Look, this industry has always been competition comes in and out with promos. That is just the nature of what we deal with on a quarterly to quarterly basis. A lot of the things that are out in the marketplace today are promos. These are not permanent pricing type things so you have to be careful how much you react to different competitor promotions and of course we run our own promotions.

So the promotional activity will always be there and I don't think it is more intense than it was, it is not like we are seeing what happened a couple of years ago where the entire industry was reset in pricing. I don't see that. I just see this as business promotional activity to try to gain ground to get some maybe incremental net adds here and there.

But I think for Verizon what we have done is we will do our promos but we are steady as she goes and we are not going to respond to everything in the marketplace if we don't think that we need to respond to. It is going to be a very logical approach because look, at the end of the day I need to grow topline and I need to grow profitability and I need to generate cash. And some of these promos you see out there they may generate growth but they are certainly not generating cash. So they are short-term and so we will ride that out. But look, I think last year proved that we were steady as she goes. We incrementally grew in net phone adds, we grew in Internet of Things, we grew in tablets. So we are on a good path here. And at the end of the day, we still believe the network is going to ultimately be the differentiator.

Matt Niknam - Deutsche Bank - Analyst

So it sounds like unlimited is not in the cards in the near-term for Verizon?

Fran Shammo - Verizon Communications Inc. - CFO

I have been pretty public saying unlimited model does not work in an LTE environment.

Matt Niknam - Deutsche Bank - Analyst

Okay. I want to just talk about postpaid churn as well. That was a big bright spot. 2015 actually came in at the lowest level since 2012. Network quality as you mentioned still at the forefront of a value proposition. As peers maybe begin to close the coverage and quality gap, do you sense there is other levers you may need to use to differentiate?

Fran Shammo - Verizon Communications Inc. - CFO

Yes, this is kind of a comical question because when you think about closing the gap, I mean even in the voice world where everyone had the same technology, Verizon Wireless led the industry hands down in every external measurement that was done. And when you talk about closing the gap, I'm investing \$12 billion a year. People who say they are closing the gap are investing \$4 billion a year. We have people saying well 5G is not coming for any time soon, I don't know why people are worried about that -- that is because they are still trying to build out their LTE network.

So look, I mean at the end of the day everybody's going to do what they do and our basis is we will continue to densify, we will continue to invest in that network very heavily because the user experience is going to be key. And there are some folks that say well, the network was more important in voice because you didn't like a dropped call, it is not as important in video. I would argue it is more important in video because the most frustrating thing for anyone is to get the spinning wheel or for a download to take five minutes when it should take 30 seconds.

So the network is going to be critical in a video world and of course it is going to be critical for us because as we go through go90 and you start to give all this data away to consumers who are not paying for it, we want them to consume more but the network has to perform.

Matt Niknam - Deutsche Bank - Analyst

You touched on 5G. Very topical these days. Verizon led the charge with LTE, appears to be doing the same with 5G. Can you talk about what you are seeing from your latest trial work and how some of the global data points give you comfort around being able to get to commercial availability by 2017?

Fran Shammo - Verizon Communications Inc. - CFO

Well, commercial availability is going to be all hinged on the FCC and licensed spectrum grants. So I think the industry could be ready to go in 2017 because the technology is there, the technology is operating in Japan and Korea. They are building it out now for the Olympics. It is delivering over 1 gig of speed so the speed is there. What the trials have to prove out right now is 5G is a line of sight technology and point to point. So what you need is you need a very densified network with small cells that can have line of sight to where you are delivering that high-speed video if you will. So that is what the trials are doing.

We have five different manufacturers performing different trials in five different areas of the United States right now on our behalf. We have had the FCC to our Basking Ridge headquarters to look at what we actually have Samsung at our headquarters who is demonstrating the 5G capability with a van that they are driving around the a parking lot. So the FCC saw the demonstration of that and saw that the speed is there and that this technology can work. It is here, it is now and really what the hold back is right now is where is the licensed spectrum going to come forward to deliver this technology? So that still has to be worked out.

It was announced at World Congress that Japan and Korea have teamed up with Verizon to lead the way to set the standards for the world. So we want those standards to get set so that we can lead this industry into the 5G world. So we believe that 5G is near-term, not far term and it is going to bring a whole different dynamic to the industry. It is going to give another growth profile for this industry. So we are very optimistic with it.



Matt Niknam - *Deutsche Bank - Analyst*

And if we think about -- let's fast-forward, let's assume it is 2017. Let's assume spectrum is freed up, it is in your hands. How do we think about use cases because I think a lot of times there is a misconception that 5G comes in and replaces 4G, we just get faster speeds on our phones but there's a lot of nontraditional use cases. So what are some of the nontraditional use cases investors should consider for 5G and how is Verizon positioned to monetize that?

Fran Shammo - *Verizon Communications Inc. - CFO*

So when you think about 5G, 5G is not a replacement of 4G. It is kind of an overlay to your 4G network so all of the fiber we are utilizing for 4G, all of these small cell in building antenna systems that we are utilizing for 4G, 5G will just sit on top of that. So it is not going to be a capital intensive replacement technology. It is going to be type of an overlay and it is going to be pretty specific use cases.

If you think about LTE when we first launched LTE, LTE was not in a smartphone, it was done through a dongle which most people bought to run their computers on and their laptops on and their tablets on. Then it matured into a chipset into the handset.

5G is going to be very similar and at this point there really isn't many use cases for mobility with 5G. It is more of a fixed point to point broadband delivery at high speed. So that is really the major use case of 5G, doesn't mean that it can't develop into more of a mobile technology but right now that is probably further off than the fixed Wireless point to point solution.

Matt Niknam - *Deutsche Bank - Analyst*

Got it. On margins in Wireless so quite a bit of announcements late last year around cost efficiency measures you put in place. When should we actually start -- have we started seeing any benefits flow through to the margins or is this more of a 2016 story?

Fran Shammo - *Verizon Communications Inc. - CFO*

Look, in the last three years if you look at Verizon Wireless, Verizon Wireless has taken out probably in the neighborhood of \$5 billion to \$6 billion worth of costs. So we will continue to drive the costs out of Wireless. If you look at it, it is the first time that we have done any type of a major reorganization within Wireless for the first 18 years of its maturity.

So we know that it is a different model now. We have to adapt to that model, we have to be more efficient, we have to get to more of a self-service model, more of an online model to become more efficient. So that is the adoption that we are taking place, we have to make sure that our customers utilize our products and it is easy for them so that they are not confused and call customer service. I mean when you think about customer service, it is a huge part of the cost structure of Verizon Wireless. So last year alone we reduced our call volume to the tune of about 30 million calls.

So we attrited out about three call centers and you are going to continue to see that trend in call ins. So that call in goes down, that means we don't have to replace as many customer service reps as they attrit and therefore we get some synergy there.

So you're going to see this and even within Wireline over the last two to three years, last year we reduced about 8000 people in the Wireline unit just from attrition and consolidation and the way we operate. So it is just a mantra that we go on year after year where we are reducing our cost structure. And we have to because if you look at the Wireless model, it has become more price competitive so you have to adjust your cost structure so that we can still deliver the same amount of profit if not more to the bottom line and I think Verizon Wireless has shown that they are very good at doing that.



Matt Niknam - Deutsche Bank - Analyst

So with some of the pressures we are seeing at least on service revenues -- I know some of that gives -- obviously some of that gets offset with a shift to EIP. Is there a view you have in terms of potential for EBITDA -- let's stick to EBITDA growth because margins get a little distorted with EIP but can EBITDA continue to grow?

Fran Shammo - Verizon Communications Inc. - CFO

Mike and I have tried to get everybody to focus on total EBITDA margin, EBITDA as a percentage of total revenue to include that EIP revenue, not service revenue because that metric is irrelevant at this point. But if you look at what Verizon Wireless did last year on that total EBITDA to total revenue, we showed that we incrementally improved that through the year and there is no reason why we should not be able to continue to do that as we become a more efficient Company. And like I said, I mean some of this is math on the top line but if you look at what happened from the third quarter to the fourth quarter if you take EIP and service revenue and you look at what we call I-ARPA, which is the installment average revenue per unit which includes service revenue, we went from a 0.2% to 0.9% so you saw a little bit of inflection point just between third quarter and fourth quarter.

So the underlying revenue is good. We are fighting through that mathematical exercise. It looks like the revenue is declining but that is really just a shift between equipment revenue and service revenue so time will come through and I truly believe that we will get back to growth by 2017.

Matt Niknam - Deutsche Bank - Analyst

You talked about synergies and fiber, two buzzwords that came up as triggers at the next question. XO recently announced an acquisition about two weeks ago. Can you talk about the strategic rationale for the deal, where it helps you the most? And then on the synergy point I think the NPV was about \$1.5 billion, what is embedded there?

Fran Shammo - Verizon Communications Inc. - CFO

So this was a very unique asset and it was held privately so it was a unique opportunity for us to pursue and the reason it was very opportunistic is number one, XO has a lot of very good fiber around metropolitan areas so they have a lot of metro rings around metropolitan areas. And based on what we just talked today, the two key ingredients to an excellent LTE network but also positioning yourself for the next generation is you need that fiber to be able to carry all of that content.

So these metro rings and their other long-haul fiber networks were a critical asset. The synergies that we talk about is because we actually pay a lot of third parties to carry a lot of our traffic to the last mile. This actually gives us the capability to move some of that traffic over to our own network when we close the deal. So there is a synergy in that.

The other thing too is it brought about 4000 additional buildings that had fiber connected to it which will be prime really greenfield for our enterprise business so they will be able to go out and start selling into those buildings that we never had the opportunity to sell into before. So that brings some opportunity to us.

But the other thing that this deal brought to us was it brought 28 gigahertz of spectrum that we are currently leasing and we have the option to buy. And that spectrum was critical because of all the R&D that we are doing around 5G and that spectrum will be utilized for that R&D development.

Matt Niknam - Deutsche Bank - Analyst

I'm going to pause here just to open it up to the floor. If anyone has questions just raise your hand. We have mic runners on the floor.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Do you have any comments that you'd care to make on the Yahoo situation including whether management has actually been open about having discussions?

Fran Shammo - Verizon Communications Inc. - CFO

I can't discuss on what actually Yahoo is doing because they are running the process and we are waiting to see what that process is. So there have been no discussions at all. Of course there is a lot of behind the scenes and everybody flurrying around because there are a lot of people that are running towards that. And look, what I have said and what Lowell has said is it is interesting but until as I said the last quote I had was until we get under the hood and really seen what is there, there is really nothing to talk about at this point. So we will let the process flow and when the process is announced and there is a due diligence room, we will take a look and then we will decide what we need to do but at this point I can't even speculate what that asset is at this point in time.

Unidentified Audience Member

What kind of return on equity do you think your business can earn in three to five years or range of return on equity? Thank you.

Fran Shammo - Verizon Communications Inc. - CFO

Return on equity is not something that we focus in on all that much because if you look at what happened when we did the Vodafone deal, we had to book a very large probably about a \$50 billion debit to our equity section so our equity section is relatively low which means we have an extremely high return on equity.

So as we become more profitable and equity builds, that is going to be a whole different calculation. So right now what we focus in on quite honestly is we focus in on the earnings per share. We focus in on our dividend policy. We focus in on our EBITDA margins from a profitability and ultimately it all comes down to how much cash can we generate from the operation. So from a return on equity it is not something I focus on because of what happened when we had a book from a GAAP perspective on the Vodafone transaction.

Matt Niknam - Deutsche Bank - Analyst

A couple of questions on Wireline. So let's start off with just broader strategy, the business if we think about enterprise SME continues to decline sort of the low to mid-single digits, consumer still kicking along FiOS obviously make up a big chunk right now and will make even if a greater chunk I believe post the spin of properties. But what are your top initiatives for Wireline today?

Fran Shammo - Verizon Communications Inc. - CFO

Obviously first off, we will close the transaction with Frontier so that is a top priority, close that out, get the proceeds of \$10.4 billion. We just announced a whole bond call and cash out of bonds of about \$10 billion to use the gross proceeds. And I have gotten a lot of questions about what about the taxes on that? The reason we are doing the \$10 billion now is to not have negative carry because the taxes on that are not due until the third and fourth quarter so we will pay the taxes mostly out of operating cash flow. So the number one priority is to execute on all that.

Number two priority from an operating standpoint is look, we have one of the best footprints there is to sell broadband and TV in. And that footprint is still underpenetrated as far as FiOS goes especially around New York and DC because we are still building them out. So we believe we still have good runway there. We are the only TV provider last year who had four quarters of growth. No one else in the industry had four quarters of TV net adds. We were the only ones.



But broadband is becoming a bigger component of that and has been for the last two years in this industry and that is a sign that people are buying the broadband because they are consuming content in a different fashion and linear TV is going to slowly decline. But even with that, we believe we can still be positive on TV because our penetration is lower, we believe we can still take market share but obviously the concentration is around delivering the best broadband experience because that is where the age group of 18 to 35 year olds want. They want the highest broadband speed they can get because they are getting their content via Wireless or via broadband. They are not necessarily interested in linear TV.

Matt Niknam - Deutsche Bank - Analyst

So on FiOS video, you recently actually made some adjustments to the custom TV offer. So can you talk about what drove this and how some of these new offers are being received in the marketplace relative to the old custom TV?

Fran Shammo - Verizon Communications Inc. - CFO

So when we originally launched custom TV I think by starting midyear last year I said at some point we are going to have to change the bundle because there are other contractual arrangements that we are going to bump up to that we need to abide by. So we changed it in February, we changed it into two separate bundles with some genre at the bottom where you can buy up for \$6 per additional bundle. And actually what we are seeing is the take rate on custom TV has actually increased.

So we were running around 33%. It jumped to 40% here since we launched and I will have more to talk about in the quarter once we get through a couple of more weeks here. But right now it is around 40% take rate on that. And the good thing now is that it is 40% on the basic and then people are actually buying some of the genres at the bottom which generates incremental RCM for us.

So by re-bundling we actually have increased our revenue if you will on the custom TV bundle which is not necessarily a bad thing for us. So right now it is going quite well.

Matt Niknam - Deutsche Bank - Analyst

And I believe on your last earnings call you talked about doing more on the OTT front. Is there any color you can provide on potential OTT plans or how an OTT product may fit into your broader video strategy?

Fran Shammo - Verizon Communications Inc. - CFO

We really haven't spent much time talking about OTT. Obviously broadband, our FiOS broadband we believe is the best in the industry so if somebody wants over the top they are going to want our broadband service to do that. But we are really concentrated on a mobile first strategy with our content delivery. Now does that mobile first strategy, that means you can take this content to your home and to Wi-Fi so if you say that is over the top, I guess that is over the top because we are running off of somebody else's network.

But the good thing about that is regardless of where you consume that data, I am indifferent because I'm still going to monetize that via advertising dollars. So whether it is on my network or my competitors' wireless networks or within your home, I'm still getting the benefit of that advertising dollar. So from that perspective if you call that over the top then that would be our over the top product which would be go90.

Matt Niknam - Deutsche Bank - Analyst

As it relates to AT&T was out there last week with DIRECTV now taking presumably an over the top product out of footprint trying to get homes that are not subscribing to pay-TV. Is that something that you would envision doing maybe longer-term?



Fran Shammo - Verizon Communications Inc. - CFO

The first thing is you have to have the rights to do that and in most content deals when you are providing, you don't have a right to take content outside of your licensed footprint. DIRECTV may be different because they are nationwide. But you have to have a broadband connection, you have to be price competitive so I am not sure what the details of that are.

But look, at this point we are really concentrating on a mobile first strategy, not an over the top strategy for just broadband alone. We are really centered around the mobile first and you have to remember too, our strategy is very different than what I would call a legacy over at the top strategy because a legacy over the top strategy is nothing more than taking linear TV content, bundling it up differently and providing that through a broadband connection and having the customer pay for that.

Our strategy is extremely different. What we are after is we are after content that is on average 8 to 12 minutes. Now put sports aside because sports is in go90, that is a different one but the content that we are really developing and some of the exclusive content we are developing are episodic 8 to 12 minute clips because that is what people watch on mobile. They are not going to sit down for the most part and watch a Netflix movie on a smartphone. It is just not -- that is not the appetite that they have on a mobile phone. So our strategy is quite different than what the rest of the industry is doing right now.

Matt Niknam - Deutsche Bank - Analyst

On the datacenter sale, so you mentioned you were exploring a potential sale of your datacenter assets. Are there any updates in terms of where you are in that process? And then secondarily, has the number of assets on the market today had any impact on demand or interest?

Fran Shammo - Verizon Communications Inc. - CFO

No, first and foremost, we have some very prime properties in our datacenter portfolio. And I mean look, it is still early stages here, we are still exploring it. We have made no decisions. We do have a lot of appetite for what we have but at this point we haven't made any decisions as to exactly what we are going to do with those assets. So still exploratory and the minute we make a decision we will certainly tell you.

Matt Niknam - Deutsche Bank - Analyst

Okay. Just more broadly on that topic though, you've got the pending sale of properties to Frontier, the datacenter process that is ongoing. Are there any other areas you think Verizon might benefit from more or less scale or presence?

Fran Shammo - Verizon Communications Inc. - CFO

Look, it comes back to -- I sound like a broken record on this one but Lowell and I have always said look, we will look at every opportunity that comes down the road whether that is a divestiture opportunity or an acquisition opportunity. And as long as they make sense and can create shareholder value and be beneficial to create something that we can use to create more value for the shareholder, we will execute on it. And I think we have shown a pretty good track record in that we are not afraid to do things that can create a lot of value for us. So we will continue to look at everything.

Matt Niknam - Deutsche Bank - Analyst

Wireline margins, so once the sale of properties to Frontier closes, I believe there is some level of stranded costs you talked about offsetting that with other efficiency measures to keep margins stable. Any updates there in terms of progress to date?

Fran Shammo - Verizon Communications Inc. - CFO

Yes, we will have more to say on this once we close but what we have said is look, the properties we are selling were higher-margin properties than the rest of our Wireline properties and there are stranded costs there. So there is a headwind pressure there but over the last year we have put a lot of things in place and you have started to see some of those things come. We will offset on the consolidated basis that so that our consolidated margin will absorb all these stranded costs. We will talk more about the individual Wireline margin once we close the deal and reset.

Matt Niknam - Deutsche Bank - Analyst

A question on capital intensity. So as we think about -- we are moving into an era of mobile video, 5G. Does that change at all your outlook for capital spend or capital intensity in upcoming years?

Fran Shammo - Verizon Communications Inc. - CFO

No, I have been pretty consistent here. Look, we have guided to \$17.2 to \$17.7 this year, \$150 million of that guidance is contractual as to what we have to spend in the three properties in the south. So a normal big BAU, you should look at us as a \$17, \$17.5 type company. And I have said you should consider us as a continuing to see what you see is what you are going to get going forward. You are not going to see a yoyo where we take it up, we take it down, it is going to be very consistent.

Now you will see some shift within that and what you have seen over the years is Wireline capital has come down, Wireless capital has incrementally gone up. But we are also shifting a lot more to the platform side of the house. So the organization that Marni is running we are actually investing more there this year than we did last year and that is coming out of the other two pools, mainly the Wireline pool. Because as when you think about Wireline as the build on FiOS has decreased, that has obviously decreased capital intensity. But also we have been at this now for 12 years. So think about all those homes that are already connected that aren't our customer. If they re-sign up, it is not like I'm going out and connecting that home that I have to relay fiber to it. The fiber is already there so the cost to add is next to nothing now. So that capital efficiency is going to continue to decline on the Wireline side of the business. But what we are doing is we are taking that and we are reinvesting in some of these other growth type products so it is just a shift within the mix. But total you should see us very consistent.

Matt Niknam - Deutsche Bank - Analyst

Just in terms of uses of cash, so now we are still obviously at the core but as you think about uses of excess cash post the dividend, how do you prioritize whether it is deleveraging, incremental investments, M&A, so on and so forth?

Fran Shammo - Verizon Communications Inc. - CFO

Look, our priorities really have not changed since we closed the Vodafone transaction. It has been the same. It is invest in our networks, obviously spectrum is there, we buy spectrum on a quarterly basis, the dividend policy is important and of course repayment of debt and you are seeing us take a large chunk of debt out with the Frontier proceeds. So look, our commitment was when we closed the Vodafone transaction that we would get back to an A- company by 2018, 2019 and we are absolutely on track to do that.

Matt Niknam - Deutsche Bank - Analyst

And in terms of net leverage, is there sort of a milestone or target that you have in mind?



Fran Shammo - *Verizon Communications Inc. - CFO*

Well I mean from just a GAAP metric it has to be around a 2.0 for all the other formulas to work with the rating agencies to get back to that A- but obviously they do their own calculation. The other pressure that goes against us is OPEB and pension. Some take that into consideration but that has been declining so that helps the ratios. And based on what we are looking at and our capital structure and maybe some other things we do around the financing receivable from a securitization standpoint or a public debt standpoint when we look at all of that, we are certainly on track to get back to an A-.

Fran Shammo - *Verizon Communications Inc. - CFO*

One of the other things that comes up from time to time is back in December I believe you referenced potentially accessing asset based security market as a means of mitigating maybe some of the cash drag from EIP. So any updates as it relates to just accessibility of that market, potential rates that you have explored?

Fran Shammo - *Verizon Communications Inc. - CFO*

Yes, it is not to offset the cash drag. I mean securitization did that so when we sold an EIP or an installment sale to our customer say it was \$700, we turned around and the banks funded that, pre-funded that receivable on a securitization basis and we called that off balance sheet financing because the receivable in essence came off our books and actually was put on the bank books.

But when you look at the capacity of the banks, the banks only have so much capacity because they have to put that receivable on their books and a lot of the US banks will not do securitization. So it is mainly the foreign banks that have supported this program. So there is a limit to how much they can securitize.

So we have actually been out there talking to rating agencies, we did a presentation at the ABS conference in Las Vegas last week. We have been talking to the bondholders. We are looking at the opportunity to potentially -- I'm not saying we have made the decision but we potentially looked at the asset-backed securities markets with the financing our customer if you will our customer receivables into the asset-backed security market.

And there's benefits to doing that. There's efficiency benefits. It is of a lower cost of capital based on the quality of that so that is something that we are still exploring and we have looked at that and talked to the rating agencies about how they would treat that. So we are still working through all those mechanics and probably have more to talk about come here at the end of the first quarter, possibly into the second quarter as we move down that road.

Matt Niknam - *Deutsche Bank - Analyst*

On the topic of EIP, so to date AT&T and Verizon have really stuck with the EIP model. T Mobile I know started with EIP, did leasing and has now gone back to EIP. I mean is there any sort of appetite from your base for leasing to date?

Fran Shammo - *Verizon Communications Inc. - CFO*

I don't know if there is an appetite. I mean we don't offer leasings so it is not even a question as to whether they would like it or not. We don't offer it. As Mike always tells me, never say never but I am pretty close to never because that puts a lot of risk on your balance sheet when you lease phones because you have to put that as an asset on your balance sheet, you have to protect residual value, there is potential that the residuals go down, you may have a write off on that. And quite honestly the leasing programs that are out there I would say are a little bit misleading because they lease for 18 months and then you have a balloon payment.

So the customer really doesn't own the phone so there is a lot of complication around leasing and I just think that keep this simple. The customer knows what they get, they own the phone, they pay \$20 a month for two years and then it is done it is their phone and we move on. So I say we keep it simple.

Matt Niknam - Deutsche Bank - Analyst

What is the expectation? I mean two years ago you had the iPhone 6 class very heavy upgrade volumes in theory whether it is those customers moving past their 24 month installment payment -- I mean there are going to be a lot of customers that presumably have an opportunity to upgrade with the potentially bigger iPhone refresh. Do you have an expectation in terms of upgrade volumes and how we should think about margins in 4Q or is that less of an issue now that we are in an EIP type of regime?

Fran Shammo - Verizon Communications Inc. - CFO

Yes, in the old world when a new phone launched and you sold a ton of phones, you took a ton of subsidies so margin got compressed. In this world where the customer is paying full price for the phone, it has less of an impact regardless of where volume is. Because if you think about it, if a customer comes in for an upgrade, I record \$1 dollar of revenue, I record \$1 of cost, it is zero profit because everybody is selling them at cost.

So if I get 100 of them, \$100 of revenue, \$100 of cost, it doesn't really impact the bottom line as much as the subsidy model. So where volumes go volumes will go, it does obviously have an impact to the top line because the more I sell the more revenue growth there is. But there is no profit in that revenue growth so we will have to start talking about recurring revenue versus nonrecurring revenue.

As far as the upgrade cycle goes, look, last year midyear I said that the volume in the fourth quarter would be less than a year ago and it was. I think until we see a massive change in technology in the handset, I think you are going to see steady as she goes from an upgrade perspective.

Matt Niknam - Deutsche Bank - Analyst

Okay. Fran, I think we're just about out of time.

Fran Shammo - Verizon Communications Inc. - CFO

Thank you, everyone.

Matt Niknam - Deutsche Bank - Analyst

Thank you very much.



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