

FINAL TRANSCRIPT

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VZ - Verizon at Raymond James Institutional Investors Conference

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Raymond James - Analyst

PRESENTATION

Frank Louthan - Raymond James - Analyst

Okay, good morning; thank you very much for being here. My name is Frank Louthan; I'm the senior wireline analyst here at Raymond James. We're finishing up the telecom presentations. I appreciate everyone sticking out to the end here. Today we're very pleased to have Verizon back with us again this year. We have Tony Melone, the Chief Technology Officer for Verizon, presenting for us. And I'll turn it over to Tony.

Tony Melone - Verizon Communications Inc. - EVP, CTO

Frank, thank you. It's great to be here. Thanks for inviting us again, Frank; we do appreciate it. It's always nice to be in Florida in Orlando and the absolutely gorgeous weather. I'm trying to think back to my slides last year. I think we might have one slide in there that you saw, so I'll make sure I go through that one quickly.

Let's start with the obligatory Safe Harbor statement. Obviously you know that we're going to be talking about some things that are forward-looking and you can refer to our website or our SEC filings for the factors that may affect our future performance. With that what I'd like to do is start and talk about our key priorities.

Back in January when Fran Shammo, our CFO, and Lowell McAdam, our President and Chief Operating Officer, talked about our business and how we were positioned, they laid out these five key priorities. And obviously these are five things that every company is striving to achieve.

And really, if you think about the essence of what we're trying to do and the mindset within Verizon, it's all about leveraging the assets that we have, the portfolio that we've built, the portfolio that we've acquired and making sure that we drive more and more out of those assets in order to be successful in the marketplace and achieve these priorities. And when we think about our assets we really think about it in a number of different ways.

Clearly our wireless assets are well-known and we feel very proud of what we've done there and I'll spend more time on each of these. Our broadband and video assets and FiOS and what we've been able to do there and what more we can do there. Clearly our global presence and global IP network is extremely important to us, extremely strategic.

And then last, the cloud, a term we're hearing a lot about. We've been in the cloud business for a long time, our acquisition of Terremark, which I'll touch on briefly. Again, we're putting more investments in this area and you've read enough about that to understand how that may or may not position us well.

So what I'd like to do this morning is talk a little bit about these assets and also tie those into market trends and why we think we're in a very good position to be in a good place going forward in our business with leveraging those assets with what the marketplace is desiring.

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Okay, so in terms of trends, I'd sum this up by saying people, consumers, enterprise customers, etc., more and more need for information no matter where they are, no matter what device, etc. That information can take the form of standard data, it can take the form of video, it could be business related, it could be entertainment, etc., it really doesn't much matter. What does matter is they want it wherever they are and they want it in a high-quality way.

And what that's driving is a need for speed, a need for mobility, a need for interoperability between devices, a need for security, especially in the business environment, but consumers as well. And all those things, you put them together and it suggests that if you're going to achieve all that you need this information somewhere centrally, the cloud. And how do we best accomplish that?

So, when we think about those trends, clearly we see video being at the front and center of that and I think we all see it. When you have online video virtually doubling every year, the consumption of online video virtually doubling, when you have 2 billion YouTube videos being watched on a daily basis, it doesn't take much to realize what's happening in the marketplace and the phenomenon and what the implications of that on businesses like Verizon might be.

In addition to that there are predictions that 90% of all Internet traffic in 2015 will be video, of which over 50% will be streaming. And the significance of that is streaming video as opposed to downloading video requires much more predictability, much more resiliency in the network. And again, that drives investment, drives positioning to accomplish that and we feel we're in a good position for that.

The other thing I'd say here is that most of these trends to date have been driven by consumers. We really haven't seen the business environment (technical difficulty). That's some microphone. So if we think about businesses utilizing video as the principal form that they communicate internally, that they communicate with their customers, you can imagine how that will further accelerate these trends.

Okay, so, the last piece of the trend environment that I'll talk about is the cloud. And quite frankly, I'm not sure there's anything I can say about the cloud that hasn't been said already. One of these days I think they're going to tell us we can do our laundry in the cloud and we'll probably believe that. But there's a ton of hype around cloud.

It's referred to in just about everything a technologist talks about these days. Here's what I would say about the cloud. There are four things that I attribute to happening that really make this concept of the cloud take shape.

One is computing power -- computing power has accelerated tremendously over the years, it will continue to accelerate, and you couple that with the efficiency of storage and the cost of storage. Then you couple that with the power of software, the virtualization, orchestration layer, whatever you want to call it, but software power has really made less and less of what we need to do require hardware.

So you take those three trends and then you take the trend of connectivity and the power of connectivity today versus five years ago, both wireless and wireline, you put those four together and you have an environment that has led to the manifestation of the IT business cloud being so much more efficient to be able to do the things that IT managers have done in various data centers and bringing that up centrally.

And it also has lended itself to a trend which I'll call the services cloud and again, providing services in a way that like the IT cloud and the business cloud really helps on the cost structure, but also helps in integrated products and services. Being able to do things across different platforms, across services, having them in a service cloud facilitates that tremendously.

Okay, so with those as the trends let's look at how Verizon is positioned to (technical difficulty) shape our business around market trends over the year. We've put a lot of emphasis on (technical difficulty) environment that I just talked about, kind of (technical difficulty) for customers is extremely important. Clearly with our 3G wireless network and our 4G wireless network and FiOS we've positioned ourselves very well (technical difficulty).

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With our global IP, think of that as a highway, getting to this information that's out there stored and very centralized and (technical difficulty) IT network positions us extremely well. We had a number of different data centers (technical difficulty) that I'll talk about in a few seconds.

And then finally, (technical difficulty) we have computing as a service, we have our base services on the wireless side, cloud based (inaudible) more to that if you think about LTE. LTE is built on an (inaudible) platform (inaudible) foundation of cloud-based services (inaudible) all of which position us extremely well.

And then across all three we have important security. As you know, we have the Cybertrust acquisition; we have a lot of very strong security assets and security knowledge that will help us evolve through it. So let's go a little deeper into each one. Let's start with the global IP and capabilities.

As you know, we're a major provider of global IP services. Over 180,000 business customers around the world utilizing our IP services. (Inaudible) cloud, the Internet backbone, over 159 countries across six continents, extremely high speed networks, our undersea cables are second to none. We've now upped the speed of some of our undersea cables to 40 gigabytes. We have -- or 40 gigabits per second. We have some of our (inaudible) ultra long-haul (inaudible) expanded to 100 gigabits per second.

(Inaudible) interconnected IP network (inaudible) 1100 (inaudible) last 12 years, which is very significant in terms of (inaudible) service quality. When you have a network that is physically connected to all of the other networks out there on the Internet where you don't have to go through third parties and (technical difficulty) service and you get that value proposition to our customers that many others cannot.

And then we have over 200 data centers (inaudible) storing our customers' information, their services, providing our services both for the customers, again enabling the global nature or what many of these customers are trying to today (inaudible).

Again, with this global IP network and with the 200 data centers that we have, we've positioned ourselves well to allow for the migration of customers from their private data centers into our data centers into the public (technical difficulty) data centers, whatever their strategy might be, we have the connectivity (inaudible) services to their location, we have the connectivity to our data centers, we will have conductivity (inaudible) Terremark (inaudible). Again, giving our customers the ability to transition those services in an elegant seamless way, that means they're (inaudible) take advantage of the assets that we have (inaudible) today.

Okay, so that's a little bit about the IP piece, the global IP (multiple speakers) data centers in the IP cloud, but there's also the concept of a services (inaudible). We tend to refer to them as a network cloud in Verizon. And it's really a subset of our own overall market (inaudible), because (technical difficulty) all our assets and then we have (technical difficulty) connecting it to the network (inaudible) services we're targeting.

We'll talk a little bit about IMS as the foundation for LTE. (inaudible) network cloud, again allows us to provide (technical difficulty). Okay, is that good or bad?

Unidentified Participant

Better.

Tony Melone - Verizon Communications Inc. - EVP, CTO

This is better. So you were having a hard time hearing me. You want me to start over, right?

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Unidentified Participant

No, no, (inaudible).

Tony Melone - *Verizon Communications Inc. - EVP, CTO*

Okay. Okay, so with that said, let me just touch on Terremark. There's not a whole lot I can say today about Terremark; we're obviously in the quiet period here. So I would say it probably is not difficult for you to visualize how the Terremark acquisition supports the strategies that we have, how it fits into what we're talking about, about building these assets on the edges, the global IP, the connectivity and then the cloud itself, that central storage location for the services and information, etc. Terremark positions us very well to achieve those strategies.

Okay, now we're going to shift to the edges. We talked about the cloud, we talked about the IP, global IP backbone, let's talk a little bit about the edges of the network. First, FiOS. There's no one that can debate that fiber is the most future proof, the most efficient medium to transmit the demands that customers will have.

We have fiber in over 15 million -- passing over 15 million homes in the network today. We will continue to expand that over the next three years, we'll probably get to about 18 million homes. I think the key for us here is to leverage this asset more than we have in the past. We have 28% market share for video, we have 32% marketshare for broadband in our FiOS territory. We think we can do better.

We think that fiber gives us the ability to differentiate more and we need to exploit that differentiation and we'll be -- you'll see a couple different things that we're doing in the environment that allow us to exploit FiOS a little more.

One of the things that we're doing is taking it more to an interactive IP nature, our FiOS network will evolve, we'll have more IP TV streaming over broadband, we'll have multi-cast IP utilizing the fiber network, we'll have media guides embedded into Blu-ray players and other consumer electronics, a very different look and feel, more interactive in nature. And also allowing us, by exploiting the IP streams, much more ability to expand the channel line-up and have some of the long tail content that consumers want.

And then finally, when we talk about assets certainly wireless, our domestic wireless portfolio is extremely important to us. On the 3G wireless side we see this as our foundation. We've built the wireless business around that. It's robust, it's high-quality, it's high reliability, it's, as I said, foundational to what we're doing on the wireless business.

But if we look ahead, we obviously think that that's not enough and we were very aggressive with our 4G plans. As you all know, the capabilities of 4G LTE are dramatic compared to what we had with 3G and what others are claiming they have with other technologies. We're seeing speeds consistently above 10 megabits per second. We've communicated 5 to 12, that's based on our engineering guidelines and principles when the network is loaded.

Obviously in its infancy here we're seeing much faster speeds than that. We are seeing the latencies we predicted and we can't be any more pleased with the performance of that network. As you know, we launched approximately 40 markets to date. 2011 we're going to be very aggressive and take that up to about 170 or so markets by the end of the year.

We have one-third of the population supported with LTE today. If I look just ahead 12 months or so from now we'll be close to doubling that. If you think about how long it took some of us in the industry to get there with 3G, think about some of our competitors arguably might not even be there today. And yet in such a short time we're going to have 4G LTE over that broad base of customers and population in the United States.

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And I will also tell you, as much as we're proud of our 3G network, which we obviously are, in my 29 careers I don't think I've ever been involved in an initiative that's been as broad, as impactful -- when you talk about 100 million pops, one-shot, brand-new technology, it has gone so well that it's given us so much optimism in terms of the next step and going forward.

The other thing I'll touch on with LTE is the eco-system. As great as we feel about the infrastructure, we knew that we couldn't afford to let the ecosystem lag behind the infrastructure. So as you know, we announced at CES 10 devices that will be on the network by the end of the first half of this year. We have two on the network today, a few more are coming very soon.

And when you couple that with the iPhone launch, you couple that with some of the MiFi cards we're developing, the LTE smart phones, etc., we think the opportunity for us to leverage the network and to leverage our brand in 2011 to drive ARPU up, to drive the broadband mobile marketplace bigger, to take our 26% smart phone penetration at the end of 2010 up to 50% at the end of 2011 where almost three-quarters of our sales will be smart phone, smart phone sales in 2011 we think positions us extremely well to continue our performance -- financial performance, our market performance, etc., in the wireless business. So we're extremely excited about that.

I'd be remiss if I talked about our assets and didn't touch on spectrum. We feel we're in a tremendously strong spectrum position. As you can see in the 10 years of Verizon we started -- we added about 60 megahertz of spectrum throughout our footprint. We now cover every square inch of the United States with spectrum. And we're going to deploy LTE, as you know, on 700 which is great spectrum.

In addition to that we have AWS, which is extremely good for capacity, incremental capacity on the network. And we have a robust inventory of 850 and 1.9 spectrum that's being used for 3G today. But as traffic migrates from 3G to 4G we can reform that spectrum and again use it for continued growth with 4G. So we feel like we're very well-positioned here.

And as I said with 700, and I think this is the slide I may have shown here last year, it's very, very advantageous to us to deploy our LTE network -- the base coverage network on 700 megahertz. The performance that our customers are seeing today is a testimony to the engineering strength that we have in the business, but it's also reflective of the power of 700 megahertz, the ability to design a network and provide coverage that meets the needs of our customers.

And we plan to exploit that advantage, the capital efficiencies that it gives us to deploy LTE allows us to go as fast as we're planning to go in 2011 and 2012 to build out this network nationwide.

Another point I'd like to make on LTE is that we're really just in the infancy of LTE. So we're really talking about these phenomenal performance characteristics and customers see that today with our broadband -- with our USB stakes and they're going to see it shortly with MiFi and with smart phones, but this is just the beginning.

The industry and the technology is evolving here and we have things coming that will enhance our ability to provide video much more efficiently, enhance our ability to overlay small microcells and picocells on top of our coverage to really get the hot spots and do it extremely efficiently. Ability to segment the market with different services and optimization and tiers, etc., so many more tools available with this technology that you're going to see us exploit over the next several years as well. So when you think about how powerful LTE is today, it's just the start and that will evolve tremendously over time.

And then finally, we feel that, again, we're so well-positioned with our assets, but we really -- now it comes to executing on our plan and if we don't execute well those assets won't mean as much as we believe they will when we continue to execute on our plan. And that execution, part of that revolves around picking the right partners to collaborate with.

In the environment we're in and the innovation that's occurring it's extremely important -- we've talked a lot about this -- that we don't try to do everything ourselves. There are things we do well, there are things that others do well. We have to pick the right partners, but even in addition to picking the right partners, providing those partners with an ecosystem that allows them to be successful.

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And we think our LTE innovation center in Massachusetts and our application innovation center in San Francisco are two ways that we're helping this broader ecosystem and our partners flourish and find ways to bring innovation onto this LTE network and we plan to continue this close collaboration going forward.

So if I take the opportunity here to sum up, I think the market trends are making connectivity, are making computing, and are making service -- the high-quality service experience so much more relevant to our customers than ever before. And when we think about those important factors now and we think about our investments in our wireless broadband network on our fiber to the home, on the highly secure global IP network and now with cloud, we think our investments position us very well to meet those three relevant needs.

And again, if we execute this well, which we have a track record of doing, I think the things that Fran and Lowell talked about in January, the five priorities, we're going to deliver on those five for our shareholders. Okay? So with that I'll stop and, assuming we have any time, I'll take some questions.

QUESTIONS AND ANSWERS

Unidentified Audience Member

(Inaudible) real quick. Appreciate the slides explaining some of the rationale with the Terremark acquisition. I think (inaudible) still trying to figure out a bit. Going forward where do you see this positioning itself from this kind of asset (inaudible)?

Tony Melone - Verizon Communications Inc. - EVP, CTO

Yes, on the data center space? Yes, I think we feel like we're well-positioned. My view is you have a couple things you have the physical data center space, which is important, it's foundational. But we have 200 of those throughout the country and now with the Terremark acquisition we'll add to that. But that's only part of the equation.

The other part is making sure that we leverage technology within those data centers that really exploit driving down cost curves and making it very efficient for ourselves and our customers. So it's a two edged sword here. We want to make sure that this same technology that we can sell to CIOs, because it's cost advantageous for them, because it's speed to market. That same technology should be used internally and will be used internally by ourselves for our own internal IT services, but then the same technology can be used on our services cloud.

So while the Terremark acquisition is a piece of the strategy, there's a lot more behind our strategy in terms of being the most -- the highest quality, most efficient provider of cloud services, whether it's for IT professionals or whether it's to provide our enterprise or consumer-based services. Okay? Yes.

Unidentified Audience Member

Can you just speak to what type of returns you're expecting on all (inaudible) price in a manner that makes this attractive to you?

Tony Melone - Verizon Communications Inc. - EVP, CTO

Yes. Well, I'll just say this, we absolutely believe that or we wouldn't be doing it. We think the environment -- we think we're very well-positioned. The demand for what we provide will continue to grow. There are not many people who can do the things we do. There are a few who do it well, whether it's wireless or wired. And we feel that that demand will continue and we do feel

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that the value that's extracted from that by our customers will be able to participate in that value chain and get the return on the investments we're making, absolutely. Otherwise we wouldn't be doing it. Yes.

Unidentified Audience Member

I've been here for three days; you're one of the few companies that even mentioned security, (inaudible) just how important is security to you and what you put out there and how they put that in perspective to the security of your cloud services versus your competitors.

Tony Melone - Verizon Communications Inc. - EVP, CTO

Yes, again, I'm not going to speak -- can't speak directly to our competitors and what their strategy is. But we think -- our brand -- the Verizon brand has a lot of attributes, but one as it is people trust it. And that goes at the heart of our cloud services as well.

We absolutely have to maintain that trust. We have to give confidence to the CIOs that if they're going to move their services into a cloud, that they want to move it to the cloud that has that reputation, that has security that they can trust and we plan to make that front and center into our proposition.

Unidentified Audience Member

So this really refers to the question that was asked before. There's a cost (inaudible), okay. So either you have to pass that cost along to increase security or (inaudible) competitive pricing arrangement as you get that data. Because clearly you think that your cloud services are more secure than the competitors. So that comes at a cost.

Tony Melone - Verizon Communications Inc. - EVP, CTO

Yes.

Unidentified Audience Member

(Inaudible) security (multiple speakers)?

Tony Melone - Verizon Communications Inc. - EVP, CTO

Yes, yes, yes, so I'll answer it this way. If you think of Verizon Wireless and the network we've built, that comes at a cost. I mean, not all networks are the same, we know it, you know it, our customers know it and there's investment that we made that others haven't made. As you can see from the margins that we churn out quarter after quarter on the wireless business that we've been able to profitably get a return on that investment and we've shown that customers are willing to pay for that extra value. And we think the cloud environment is similar.

Does that mean we're going to be the biggest player in the cloud space in the industry? Maybe not. Does that mean we have a particular space that's very effective in certain verticals? That security is valued and very important? Possibly. So I think you're making very good points, I think fundamentally we do believe that security is valued and as a result of that we'll be able to get a return on the investment we make.

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Frank Louthan - Raymond James - Analyst

All right. Thanks, Tony.

Tony Melone - Verizon Communications Inc. - EVP, CTO

Yes.

Frank Louthan - Raymond James - Analyst

(Inaudible). Thank you.

Tony Melone - Verizon Communications Inc. - EVP, CTO

Thanks.

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