

# FINAL TRANSCRIPT

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## **VZ - Verizon Communications Inc at Robert W. Baird & Co., Inc. Technology Conference**

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## CORPORATE PARTICIPANTS

### **Kerry Bailey**

*Verizon Communications Inc. - President, Terremark*

## CONFERENCE CALL PARTICIPANTS

### **Will Power**

*Robert W. Baird - Analyst*

## PRESENTATION

### **Will Power** - *Robert W. Baird - Analyst*

It's my pleasure to be able to introduce our next presenting company, Verizon Communications. Representing Verizon we have Kerry Bailey, President of Terremark, which is the data hosting call business within Verizon. We also have several other folks from Verizon today -- from investor relations Kevin Tarrant and Hunter Blankenbaker and also Chris Gesell from Terremark. So welcome to everybody.

Kerry will start with a few opening comments and then we will sit for a fireside chat. So, Kerry, welcome.

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### **Kerry Bailey** - *Verizon Communications Inc. - President, Terremark*

So good afternoon. I appreciate you coming in. I want to talk a little bit about Terremark, which is really a 100% owned subsidiary of Verizon, and specifically this little thing called cloud, if you have heard of it before, and kind of our approach into this thing called cloud.

But it is exciting times in the industry. It's also very disruptive times in the industry and I am going to talk a little bit about why it's exciting, why it's a little bit disruptive, and then kind of our approach going after this market.

So from a Verizon standpoint when we look at this thing called cloud it's really a new IT delivery model. It's the third wave of IT, it's going to be bigger than the Internet -- there is a lot of things being said out there, but we fundamentally believe that this new IT delivery model that is upon us right now is transformational in the industry. So from a Verizon standpoint we look at it and we say simply, the market is moving in our direction. It's a network-based, asset-based movement, and we feel very good about that direction that this new IT delivery model is moving into.

From a business standpoint, businesses look at it and it is transforming their business model, so that is a good news story for us as well. From a market standpoint, from an IT industry standpoint, everybody is reinventing their business models as well and that is also a disruptive piece.

But I will tell you for me personally, if you think about the era that we have gone through where we were outsourcing, we were hosting, we were managed service providers, we were application service providers, something -- we were trying to deliver IT as a Service with the assets we had, but we never got to the point where we are today. Those planets have now aligned because of a couple of things.

Broadband, whether it's 4G, 3G, or global MPLS backbone. They weren't there when we were trying to do the traditional managed services and application service provider type business. The second thing happened was virtualization came upon us and when that hit us it made IT a little simpler for us. Before we were standing up individual stacks of equipment trying to make that work as a service provider.

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Then the third piece, and really there is almost a fourth piece to it, the adoption. Enterprises are adopting the cloud movement, that happened in the consumer world and it's moving into the enterprise world. But that is a significant movement in the market right now around cloud in general and that is why we are betting pretty big on it.

From a Verizon standpoint, we have said everyone wants to become a service provider now. That is what is happening in the industry; think about how disruptive it is. We used to think hardware providers, well, they stayed in their world and they sold hardware to enterprises. Software companies sold their software, telecom companies come in and sold a network, and a systems integrator came in and made it all work.

Well, now completely disruptive because all of that happens in a platform called a cloud space and you can do it in minutes, not months and hundreds of thousands of dollars. That is a major transformational movement.

So when we think about that disruptive thing that has happened in the market, we looked at it from a Verizon standpoint and said, well, you could be disrupted or you could be the disruptor. Our investments show that we believe in it. We bought a company called Terremark recently, a company that I was a part of called Cybertrust, was a security company about four years ago we acquired, and we just bought a company called CloudSwitch.

The idea of all of those acquisitions was to take the access that Verizon has today -- our global network, our global 4G -- our 4G network and our 3G network, our data centers that are around the world -- and couple that with a cloud platform, a security platform, and an easy way that enterprises can move applications to the cloud. And fundamentally that is our strategy and that is why we are betting big on it is because we see that it is a transformational movement in the industry.

So couple of things. Safe Harbor, I will be making some statements today all underneath the Safe Harbor.

From an addressable market the one thing you should think about is it's a \$3.5 trillion market and what does cloud show? Maybe \$150 billion in a few years.

We are in the early stage of it and we are in the early stage of enterprises adopting, although it is accelerating from an enterprise standpoint. We have seen customers come in with \$40,000, \$50,000 MRR, monthly recurring revenue, on the cloud platform and in six months they are at \$0.5 million. The adoption is moving a lot faster, I think, than what a lot of the industry analysts are saying out there.

Equally, scale is going to win in this business and we think there will be probably be five companies in the world that will be able to operate at the scale that we can operate. Here is a good example. This slide basically says that when we are running millions of virtual machines for customers around the world we are going to be able to scale at a point that many won't be able to scale at.

Private clouds can't scale at that today because you will never utilize the resources that are in that platform. But when you think about all of the workloads that we are moving from an internal standpoint and the fact that we are going to be on a global basis, the scale will ultimately win in this business and in the adoption and drive the costs down for the enterprises.

The next thing is what CIOs are going through today, and I think this is the curve that we are seeing in the adoption phase of moving to cloud. It first started off on this left-hand side of the slide showing the variable workloads, those development environments, e-commerce. By the way, e-commerce is very hot again. We are seeing more and more workloads moving to our cloud around e-commerce. But those variable workloads were the first ones moved in.

But all of a sudden, over the last nine, 11, 12 months we have seen a significant movement of what you would call of these commodity IT applications -- SAP, Oracle Financials, all of the ERP CRM applications. Those applications are now moving to the cloud and customers are finding that the cost to do it, what they are saving, the agility that it can offer, the speed to market it can offer is happening.



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So in our model we have colocation 50 centers, we have hosting, and we have cloud. And the CIOs are coming in and looking across all their applications and we are helping them to say which ones should really sit in the cloud, which ones should sit in a private cloud, which ones should sit in a hosting environment, and perhaps which ones should sit in a colocation world.

When we did the acquisition of Terremark we did what was called a reverse integration. We took the Verizon business assets of our data centers, our security business, our cloud business, and we combined it into Terremark to go after this space so we could have the scale to offer what we call a hybrid mode. That hybrid mode isn't a hybrid cloud, but it's a hybrid way of deploying a CIO's applications across this continuum.

The next challenge in the market right now is that there is a chasm that sits between commodity clouds, consumer clouds, and enterprise clouds. The acquisition that we did and the assets that we have brought together underneath Terremark was really built to drive the enterprise cloud. We are filling that gap today, but you see a lot of companies developing in some of the commodity clouds and then they want to move them to an enterprise cloud. And how do you do that? Hence, the acquisition of CloudSwitch which allows you to move applications behind your firewall or from other cloud providers to ours and back and forth. So we are filling that gap from an overall strategy standpoint.

So I will end on this slide, Will, and we will go to questions. But this is a massive transformational change in the industry; we all should understand that. It's at a very early stage. Scale is ultimately going to win on this. Having the assets of the network, the data centers, our 4G and 3G assets because mobility and cloud come together very quick, especially under things like machine-to-machine. It's a very exciting time for the business and the industry, and we are going to continue to bet taking this space to enable the enterprise cloud.

Okay, Will?

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## QUESTIONS AND ANSWERS

**Will Power** - *Robert W. Baird - Analyst*

Great, thanks. Thanks, Kerry, for that background. So you completed the Terremark acquisition. I guess maybe as a starting point, can you update us as to where you are in that integration, how far along are you? What are the stepping stones still in front of you?

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**Kerry Bailey** - *Verizon Communications Inc. - President, Terremark*

It's a good question. So we did something that was relatively unique in the idea that we did this reverse integration, and the idea was that you had to put these 50 data centers together around the Terremark cloud ready data centers. We felt like in the adoption of cloud you needed a world-class security business. We put the Cybertrust assets in there as well, as well as our professional services to enable it.

So we put all those assets together and the idea was then to quickly get in a point that the sales teams, the product teams, the operations teams, the client care teams, on and on and on was quickly integrated and utilizing the Terremark processes. We are well down the path. The sales has been integrated, product rationalization has gone on, and we have really been working on 2012 launching the combined team and the combined assets together. We just launched a new website today, but we are pretty much almost through that reverse integration right now and finishing up on the sales piece right now.

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**Will Power** - Robert W. Baird - Analyst

Talk about the interaction and kind of the marriage of what you are doing then through Terremark with the other businesses at Verizon, both network assets but also wireless, given the importance of mobility in the cloud.

**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Yes, that is a great question. So first of all, you have to look at the cloud asset as a complete Verizon asset. Verizon is a Fortune 13 company. It is using our cloud to run our business as well, that also helps us get scale.

The second piece is that because our products are being launched. Whether it's over-the-top products or machine-to-machine products out of wireless, those products are being developed on the cloud and then serviced out to the markets. So whether it's consumer, whether it's wholesale, whether it's retail, all of those units are using it. And I think the biggest one that we were working on is our machine-to-machine cloud right now getting that out to the market with our wireless teams.

**Will Power** - Robert W. Baird - Analyst

Okay. Can you talk a little bit about the competitive environment out there? Who do you all run up against? Is it traditional telco providers like an AT&T, which I am sure it is in some cases?

**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Yes.

**Will Power** - Robert W. Baird - Analyst

Rackspace, other data hosting companies? How do you kind of think about the segment marketplace out there?

**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Let me go back to my opening remarks, I think we are in the most disruptive state that this industry has been in in a while. Before everybody stayed in their nice, tight little boxes and we said if you are a telecom company you are going to compete with a telecom company, hardware is going to compete with hardware, software software, SI SI. That is clearly not the case anymore.

A lot of hardware companies have announced their products into public and private clouds. We have seen software companies do the same thing, some systems integrators. So our competition today I still predominately will tell you is the internal teams trying to move workloads outside of their own enterprise data center, but the competition is coming from all over the place right now from a standpoint of everyone trying to be in this business. We feel pretty comfortable that our heritage has been an enterprise class service provider and that we have got some really world-class assets out there to compete with everyone. But it's coming from all the areas of IT right now.

**Will Power** - Robert W. Baird - Analyst

So if you think about go-to-market strategy, selling points as you compete against the breadth of competition out there, what are the one, two, three things that you think really help differentiate you in a sales pitch in front of clients?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

I think there is probably about four things. One of them is if you think about how we integrated the assets into one unit to deliver a combined portfolio that is very important, because we are a leader in the cloud; we are a leader in security across the world. So having leadership positions in that area is important.

The second one is being global and having a global cloud, global data centers, and a global network around the world has been significant for us. Having the security assets that we have has been significant as well, and then a global professional services team that can help customers through this real change in the market. Those are probably the biggest ones we have.

Then you are going to see more and more on the wireless side as we enable more and more of these cloud applications to come across -- handsets and tablets, and those pieces.

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**Will Power** - Robert W. Baird - Analyst

You touched on security. Can you delve into that a little bit and maybe try to help us frame the importance of that as you are talking to enterprises? Is that the number one objective? Where does that kind of rank because you do seem to have some advantages there given?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

There were really -- I think there were three major kind of adoption issues, if you would say, with cloud, especially from the enterprises coming out. One of them was performance and that was really, can I get the performance out of the cloud across my network? We certainly own some of the best assets from a network standpoint, so we think we have answered the performance piece.

The second issue was always around security and I want to dig a little deep into that. Security doesn't mean do you manage my firewalls well or do you stop intrusions well? It's everything from risk, compliance, identity, threats, vulnerability. It's the complete stack so we are -- that was 4.5 years ago when that acquisition took place and we integrated security in everything we sell.

If you buy a network asset from us there is an element of security that is built into it. If you buy cloud, our cloud was built so that it has got 1,500 controls in it that if are a banking industry or a retail industry and you have to pass audits those controls are in place. So it's not a question of do you have security. You must have security and that piece is well integrated across the platforms.

The last piece of objections there outside of security was, can I move my applications? And that was the acquisition of CloudSwitch where you can literally move your application to our cloud, the security controls, the encryption everything goes with it and the customer can manage it. And that is really the basis of how security works around the cloud.

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**Will Power** - Robert W. Baird - Analyst

So you bring up CloudSwitch; as you think about the portfolio of acquisitions you have done and the things you have worked on organically are there other holes in the portfolio that you think you need to fill or do you feel pretty comfortable with the portfolio of assets you have now?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

When we looked at those -- we looked at the real objections to cloud, so we have done acquisitions in those three areas to help us there. I will tell you the first thing is CloudSwitch was a software acquisition and not many telecom companies are out buying software companies. But the cloud in itself needs software, it needs platforms, and that was very, very important to us.

So we feel pretty good where we are from a global capacity standpoint in our data centers, our global cloud aspects that we have. We will continue to do a lot more software development, but as you would guess, if you looked at the acquisitions we have done we will always be opportunistic on anything that can get a great return.

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**Will Power** - Robert W. Baird - Analyst

Let's talk a little bit about mobility, that has been a hot button topic among a number of presenting companies today. Can you frame a little bit what you are seeing there? Are there certain applications that just are more geared towards mobility, or is it a function that enterprises want everything to be mobile?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

First of all, I think everyone should understand at least what we are seeing. Mobility and cloud they go together. That mobile device or that tablet you are using has to get back to an application, it has to store data. It's the perfect connection of two technologies or two things that are moving in the industry right now.

What we are seeing from an adoption standpoint is really going to come down to a lot around machine-to-machine. We have worked with a lot of companies, automobile manufacturers that have machine-to-machine devices in them that connect back to our cloud that is running applications to inform the consumer, do various things for the consumer, kind of connecting the B-to-B-to-C kind of connection. That has been something we have seen a lot around, again, machine-to-machine.

We have seen around the -- in the trains, as an example. How trains can communicate where they are back to an application in the cloud to notify if there has been any kind of switching errors and managing kind of the whole positive traction around where the trains are. So a lot around machine-to-machine and we are seeing a lot in healthcare as well. The ability to have an application to be able to -- whether you are in an emergency room with a doctor and you can have video there, how is that data protected from a security standpoint, stored in the cloud, and then moved back. So still early on I believe, but I think it's going to hockey stick.

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**Will Power** - Robert W. Baird - Analyst

So if I step back and I think about the business mix that you have today and the combined assets, where are you today or is there a way to kind of break that up in rough terms? And where do you see that going?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

From a standpoint of all of (multiple speakers)?

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**Will Power** - Robert W. Baird - Analyst

Colo and the different revenue streams that --?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

If you think of our business now of colocation, hosting or private cloud, cloud and security, by far cloud is the highest growth item that we have. That growth -- I would say that if you looked at colocation early on, colocation was probably driving of that portfolio 50%, 60% of the sales. That is down into the 30%, 40% sales right now. Cloud takes up to 60% at times.

So that is the movement that is happening and that is why I think cloud adoption is moving a lot faster than we had originally thought. So I think if you look at our mix cloud is absolutely number one that is going to happen and then it's a pretty even mix between security, colocation, and private cloud.

**Will Power** - Robert W. Baird - Analyst

If there are any questions in the audience we are happy to take a few. If not I will continue to tack on here, one of the questions I get from investors pretty routinely, and I am sure you all do as well, is the macro environment out there. Give us a sense of your perspective on that front. Have you seen much impact, because you look at your European business now that you are global in scale, are there certain geographies that are performing better or worse than others?

**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Actually got this question a few times. From a macroeconomic standpoint there is two things that I think buck the trend here for enterprises. Enterprises are willing to spend money if it's saving them money or enabling their business or driving new, sustainable revenue streams and they are spending money.

Again that is why I think when you look at the amount of cloud that we are selling today it ultimately is allowing enterprises to be more agile, drive costs out of their business, lower their CapEx, all of those pieces. That is, I think, bucking the trend that they don't want to worry about on the macroeconomic. If you can save on enterprise money, you are in good shape.

I think from a federal government standpoint we have been asked the question, well, is that slowing down? The reality is in the US the cloud's first initiative of moving at least one app to the cloud -- and we have got FISMA and DIACAP certified data centers and cloud platforms -- they are moving significant amounts of workload to us. And we are running in the high 90% of the type of sales, percentage of sales being all cloud to the government.

So I think certain products could be more impacted, but this portfolio has not at all been impacted.

**Will Power** - Robert W. Baird - Analyst

Okay, that is good. It's good to have some good strength behind you.

**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Yes, exactly.

**Will Power** - Robert W. Baird - Analyst

So you talked about the cloud services and that being probably the single strongest area of growth. As we kind of look forward at the various cloud services on demand, capabilities you are providing, does everything go to the cloud or has it become a more bifurcated market where there are some applications that work better on the cloud on some that stay on a home network? How do you kind of think about --?



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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

We fundamentally do not believe that all applications will move to the cloud. It's just not going to happen. If you go back to the slide we had, I believe that you are seeing those variable workloads move; we are seeing the commodity apps move. I think there is going to be significant movement and activity in that area for several years.

The long tail on traditional IT will be there. As we said, it's a \$3.5 trillion business and cloud is \$150 billion right now, so that long tail on IT is going to be there for a long period of time. I think what is happening, though, is the inertia that is behind it is, first, I want to take advantage of infrastructure and the flexibility of Infrastructure as a Service.

I will take the app I have written maybe five years ago, 10 years ago, I will put it on the cloud, I will run it in a virtualized environment, and I will save money based on infrastructure. But you are soon going to soon see those applications being rewritten also to take advantage of a lot of the cloud OSs that are out there right now and you will see that take off. But we have got, beyond my lifetime, a long tail on traditional IT.

**Will Power** - Robert W. Baird - Analyst

So you think about the adoption curve you are seeing in the cloud today, what are the primary roadblocks that you run into when you talk to customers? What are the reasons maybe they are not adopting the cloud at this point?

**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

I think the first one is there are almost two CIO mindsets out there. There is a progressive CIO that says this is a big change, this is going to change how the business in which I operate in can be enabled by my services, and they are very progressive in the adoption of cloud. They are willing to test the first workload. They are willing to put it out there and then you see this thing take off and grow.

The other mindset of the CIOs we are seeing is much more of a traditional set that says, you know what, I run a pretty big operation. I have got my processes down; you are not going to save me any money. And it's almost the argument that we had back many years ago about outsourcing, there was the resistance to do so.

That is probably the biggest difference right now when we start talking to enterprises is do we have a progressive CIO? If we do, we can enable them pretty quick. If we don't, we have to really educate and it's a constant education.

This is not a sales cycle any more of let's show you a demo and let's show you some characteristics of the product. It's really working with that CIO and educating them on it. So a lot of education, a lot of let me dip my toe in the water and try it first. Then you will find out they like it and the adoption moves.

**Will Power** - Robert W. Baird - Analyst

Okay. I think we are --

**Unidentified Audience Member**

(inaudible - microphone inaccessible)

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Question is how am I recouping the cost?

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**Unidentified Audience Member**

(inaudible - microphone inaccessible)

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**Will Power** - Robert W. Baird - Analyst

For the sake of the webcast, the question is, how are you charging your clients effectively?

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

So couple of different models here. First of all, when we build out a cloud-ready data center. That is a campus data center that has our entire portfolio in it. So within that data center we have cloud, we have our security services, we have colocation, and we have our hosting and private cloud offerings.

When you look at the return on that capital we have really had good returns when you look at that entire portfolio. So we are building those campus areas, putting the entire portfolio in, and our returns are very, very good.

And the way we charge for that are all different. The cloud is still based on pay-as-you-go models. A lot of the enterprises though are charging or want us to give them an enterprise type contract and be able to burst up to pay-as-you-go. But, ultimately, they are still paying in kind of a cloud-based pay-as-you-go. And the colocation prices are all built on one-year, two-year, three-year type contracts.

So much more traditional in those products, cloud much more pay-as-you-go, but we are very pleased with the returns on the capital that we have invested so far and that we are investing.

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**Will Power** - Robert W. Baird - Analyst

Great. Kerry, thanks for those remarks. That is a great background of the business. Please join me in thanking Kerry for his presentation.

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**Kerry Bailey** - Verizon Communications Inc. - President, Terremark

Thank you, Will.

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