

# FINAL TRANSCRIPT

**Thomson StreetEvents<sup>SM</sup>**

## **VZ - Verizon Communications Inc at UBS Media and Communications Conference**

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## CORPORATE PARTICIPANTS

### **Lowell McAdam**

*Verizon Communications - President & CEO*

## CONFERENCE CALL PARTICIPANTS

### **John Hodulik**

*UBS - Analyst*

## PRESENTATION

### **John Hodulik** - *UBS - Analyst*

Thank you all for being here for UBS's 39th annual Media and Telecom Conference. My name is John Hodulik; I am the telecom, cable, and satellite analyst.

I am very pleased to introduce our morning keynote speaker. Lowell McAdam took over as CEO of Verizon in July having previously served as CEO of Verizon Wireless. Lowell, thanks for being here.

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### **Lowell McAdam** - *Verizon Communications - President & CEO*

Thanks, John. Good morning, everybody.

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### **John Hodulik** - *UBS - Analyst*

It seems like we got a lot to talk about this morning.

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### **Lowell McAdam** - *Verizon Communications - President & CEO*

A little bit is going on, yes.

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### **John Hodulik** - *UBS - Analyst*

It probably makes sense, I think, to start off with the deal announced on Friday, the \$3.6 billion purchase of SpectrumCo.

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### **Lowell McAdam** - *Verizon Communications - President & CEO*

Yes.

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### **John Hodulik** - *UBS - Analyst*

Can you give us the highlights of the deal as you see them from Verizon's perspective?

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### **Lowell McAdam** - *Verizon Communications - President & CEO*

John, I think there is probably two major aspects to this. First, obviously the spectrum is a big purchase for us.

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If you look at our inventory of spectrum, we have 700 nationwide, which is the foundation of our 4G LTE deployment which is -- we will probably talk about it. It's going very well for us. But we also have AWS mostly on the East Coast and the SpectrumCo holdings sort of start at the Mississippi area and match up extremely well with us on the western part of the US. So it really was a hand-in-glove opportunity for us to be able to add capacity to LTE where we need it through the AWS holdings. So we are very pleased about that.

We feel good about it from another perspective, too, as we have talked with the FCC and Chairman Genachowski and others that one of the problems with our spectrum inventory for the nation is that there was a lot of spectrum that was warehoused. This takes spectrum that really had no plans for being put into commercial service and gets it into somebody's hands who will make that commercial in the very near term here. And so that will spur additional investment and innovation.

So I think that is a very good story and we are just beginning the dialogue with the FCC on that now.

The second part of the deal, which I think is very important to the industry, frankly, both the cable industry and the mobile industry, is if I look back 18 to 24 months ago we saw what the promise of LTE was and we looked at our FiOS asset. We said, wow, finally you are going to be able to do these quad-plays and have video move seamlessly between the desktop and the TV set and your tablet and your smartphone. The technology base will really support that.

So we were well down the road in developing that for FiOS and then the opportunity came up to partner with Comcast -- that is where the discussions really began -- that gave us the nationwide play. Because while we could do it and do it very well within the FiOS footprint, wireless is a national asset and I needed to look for an opportunity to expand that scale. So that is when we started talking about a joint venture where we could develop these integrated, truly integrated products and bring them around nationwide.

And so that, to me, is the second major aspect of it. The cross-selling of services is just a way to get those sort of products into the marketplace.

Now I think that one thing the administration has been very clear about is wanting to create jobs and have innovation. This is a real innovation engine I think. Gives us the opportunity to enlist all of those developers that have created half a million applications for the iPhone and the Android ecosystem and say, okay, guys, here is an opportunity to really leverage this network, this hybrid network. What can we do with it?

So we will do lot of applications development ourselves. We are already well down the road with some of those, but we are going to enlist that other innovation engine to see what we can really spark in the industry.

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**John Hodulik** - UBS - Analyst

Verizon Wireless managers have said in the past they would need additional spectrum in 2015 or maybe just first starting on the spectrum piece of that. How much more additional runway does the addition of the AWS spectrum give you?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, it depends on the adoption of these sorts of services and how video intensive they are. I think everybody knows the efficiency improvements of LTE and the AWS gives you a lot of extra capacity there, so ballpark from our perspective we think we are in the four- or five-year kind of range, maybe more. There is an awful lot of work going on on compression techniques, but it's not sort of the end game for us.

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I think, as I have talked with the commissioners and others, you really need to continue to push to have more spectrum available across the industry, but at least for us we think we have gotten some significant breathing room here. Then we will deal with things on a market-by-market basis as we go forward.

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**John Hodulik** - UBS - Analyst

Since you touched on the spectrum policy, I mean can you talk about what Verizon's position is in terms of getting more spectrum into the market? Maybe what -- there is a lot of talk about incentive auctions or the D Block. What looks attractive in terms of what could come to the market and over what time frame are we talking?

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**Lowell McAdam** - Verizon Communications - President & CEO

I wrote an op-ed, the New York Times carried it about six weeks ago, and outlined what I think we need to get done here. But first I think the FCC really needs to facilitate getting the spectrum that is out in the inventory into the right hands. There is an awful lot of venture capital companies and smaller carriers that have the spectrum and they really can't afford to build it out. If we can pass it through a streamlined process at the FCC, I think you will get it in the hands of people who can build.

Second thing we need to do is get the broadcast spectrum sort of repositioned. I know there is a lot of controversy around that, but there is a lot of that old broadcast spectrum that we really need to get through a secondary process. Then I think the military spectrum there is -- the FCC, I really salute them for wanting to get that extra big chunk out there, but typically that takes about nine years from the time it's identified until it gets into commercial hands.

So I think we have got to do all three of those and then we have also mentioned, I think, the D Block. We really need to get the D Block resolved. Our view is let's get it to public safety. Let's get the carriers to help them build that out so we have that interoperable network.

It's really embarrassing to me. We are sitting here in New York City after 9/11 to have -- to still not have a decent public safety network is an embarrassment, and I think we need to get that done and get that network up and operating.

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**John Hodulik** - UBS - Analyst

Switching over to the partnership with Comcast, I guess first, can you talk a little bit about a timeline? It sounds like -- Comcast was here on Monday talking about beginning to work together very quickly on this.

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**Lowell McAdam** - Verizon Communications - President & CEO

Yes.

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**John Hodulik** - UBS - Analyst

It sounds like you will be starting to sell each other's products in the new year. When can we start to see some applications or new products and services?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, we are going to roll out in four markets in January with the typical quad bundle. I mean it's really not anything more than cross promotion, because anybody that is in an operating business you know the systems work that needs to be done to get these applications.

We have got an applications roadmap and there is a steering committee that already met once and there is another meeting next week that will agree to that. I would suspect in the second half of the year you are going to begin to see what will be relatively simplistic products.

But by the end of the year we really believe that we should be able to do things like a videoconferencing that works between your TV set at home and your PC and your tablet device when you are out and about. And other things will roll from there.

The general concept on the products are as you walk into a home your device will sync up with your set-top box and you will be able to access the content. Now we have got a lot of work to do with content providers. We think that this is a win-win. We can get a lot more eyeballs on the content.

So we need to figure out what those right models are and we are just beginning those discussions, but once we get that worked out I think the applications will come relatively swiftly.

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**John Hodulik** - UBS - Analyst

In terms of your business, one of the questions I have been getting was you are going to be cross-selling cable product in your areas, in your footprint. Even in areas where you have FiOS. Do you expect this to affect the trajectory you are on with FiOS adoption?

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**Lowell McAdam** - Verizon Communications - President & CEO

No, this obviously, as you can imagine, was the topic of deep discussion with Comcast and Time Warner. The theory is, though, that all boats will rise, so FiOS will not be disadvantaged in any way. If I put my Verizon hat on, we think that the FiOS platform is the strongest platform and each partner can take the core product and do some innovation on top of that if they choose to.

So I think FiOS will have a bunch of very good products that will come that, frankly -- and come faster than it would have come if we tried to do it on our own. So I think there will be continued advantages and there will be a very strong competition between the different players.

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**John Hodulik** - UBS - Analyst

Then just lastly on the topic, is there any concern that -- again, as far as the agreement was concerned there is some cooperation on the wireless side. The cable companies are now rolling out WiFi in a lot of their major areas. It looks like after four years there could be an MVNO that the cable companies have.

Is there any danger that in providing them what might be attractive prices on the wholesale side that you may be enabling a new competitor in the 4G space?

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**Lowell McAdam** - Verizon Communications - President & CEO

I think that is the reality of the situation we are in. As I talked with Brian he said, look, if I sell you this spectrum that puts me on a particular path. I need to have a fallback that if this doesn't work as well as we had hoped that I am not blocked out of wireless. And I had to respect that as a partner.

An MVNO will have added burdens for them. If they choose to go that path, they will have to make that call, but it will be profitable for us if they do go that way. So it's a win-win I think for both of us. I think we both believe the real prize is creating this innovation engine and creating a seamless product set across mobile and fixed. But if it doesn't go then we both got fallbacks that are positive for the business overall.

**John Hodulik** - UBS - Analyst

Okay. Switching to LTE, you are obviously in a very strong leadership position in 4G. How much of a first-mover advantage do you think you have?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, it's a little hard to say. It depends on how others direct their resources. But if you look at what has typically happened over the year, we think we are 18 months or so, maybe 24 months, ahead of the competition.

This has been just a classic example for me. If you look back two years, when LTE is not ready, the ecosystem won't evolve. We invested in the Innovation Center for hardware in Waltham, Mass., for software in San Francisco. We have had just a flood of folks -- it's the classic if you build it they will come -- and the ecosystem has developed far more rapidly than we had even hoped.

The technology -- as you and I were saying out in the hall there, I have been around the business for a long time and this is one of the few technologies that you go, whoa, this is really a difference. And that is part, as I said, what spurred us to do this video play.

So I am very pleased with where we are. We are redirecting resources to make sure that we build out LTE even faster than we planned. As you know, this year we said we were going to get 185 million. We will finish at over 200 million POPs covered, so we are accelerating because we like the way it makes the business look.

**John Hodulik** - UBS - Analyst

As LTE gets rolled out and more data-centric devices proliferate and the market sort of shifts more from voice and text more towards data does the mid to high 40% margin that you guys have enjoyed, is there any risk that that comes down?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, that is not our target for sure. Inside the business it's hold it or take it up, and we see opportunities to do that through streamlining processes. Obviously, the technology change with LTE with the capacity improvement and the cost per megabyte comes down dramatically, so we think we are in a position to hold or slightly improve those sorts of margins.

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**John Hodulik** - UBS - Analyst

You have also said in the past that smartphone penetration will continue to drive ARPU and certainly that is what we show in our model. How far into this smartphone sort of shift are we? Obviously, Verizon is a little bit behind and rapidly catching up, but how high do you think this penetration can go?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, one of the advantages we have of our international presence through Verizon Business and our partnership with Vodafone is we get to look and see what goes on around the world. We are at 40% penetration now, well on our way to 50%. We will probably be a little bit off from what we had suggested in January, but there are markets around the world that are at 70%.

If you look at -- I like to think of these as stepping stones, but if you look at LTE as one stepping stone, this video play that we have is the next stepping stone, everything is driving a customer more to tablets and to better quality smartphones. So I don't see any reason why 70% isn't in our future here.

**John Hodulik** - UBS - Analyst

And as we do that and we start talking about multiple devices the way that you bill people is likely to change as well. When can we expect to see account-based billing?

**Lowell McAdam** - Verizon Communications - President & CEO

I think in 2012 we will see it. We have been working on this for a couple of years. Frankly, when you have got 100 million subs and systems you have got to work through, but I think that will be the case because we see four screens or even five screens.

If you look at all the machine-to-machine capabilities that are out there, customers don't want -- and neither do we, by the way -- want an individual account for each one of those devices. It drives them crazy and it would raise our costs a lot. So getting to one bill and having account-level pricing is the right way to go.

**John Hodulik** - UBS - Analyst

Is there any potential risk of ARPU dilution as we move to that type of model?

**Lowell McAdam** - Verizon Communications - President & CEO

When I started out in the wireline company in Pacific Bell in 1983 they were saying we have to be careful about bundling because there will be bill shock and all that. The key is to make sure you have got the applications the customers want.

There has been a lot of questions, for example, about the iPhone sells at \$199 and we are selling some of the new 4G stuff at \$299 and they are selling very well. If you have got the device and you got the service that the customers want, especially with our base because we are such a heavily postpaid, higher credit score customer, they are going to buy it. So to me the issue is are we going to have the applications that justify it. If we do, then I think we will be fine.

**John Hodulik** - UBS - Analyst

As you were saying a lot of these higher end 4G devices are \$299.

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**Lowell McAdam** - Verizon Communications - President & CEO

Yes.

**John Hodulik** - UBS - Analyst

But at the same time you have got this double your data promotion out there for 4G to try to move people over, and I guess these are a couple different levers that you could use. But could you talk about that promotion and what do you think it's -- or maybe talk a little bit about what it's doing in terms of adoption, usage, ARPU, and then the impact on the CapEx?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, the reason we did it was really because of the CapEx. We will get to a point here where we will strand 3G capacity because we want to move as rapidly as we can to 4G for all the obvious reasons.

So we are selling a lot of 3G devices. The 4G devices now, I believe, are very competitive and, because of some of the 4G capabilities, will even be superior. So I think we want to accelerate that move over.

So while we are holding the subsidy down on those and charging \$299 for the device, we want to stimulate the usage on the 4G network which is relatively empty at this point. So we aren't seeing at this point a ton more usage on 4G; a little bit more, especially when you get into the tablets and you start doing some video.

But as we layer on these applications we want to almost pre-seed the base so that when these integrated applications come out we are not starting from scratch with devices. We have already got 4 or 5, 10 million devices out there. So I think it's a way for us to get up the hockey stick very quickly.

**John Hodulik** - UBS - Analyst

Got you. You were talking about the CapEx side. Your spending sequentially from second to third quarter came down quite a bit, I think a lot of it because of EVDO. There has been some concern that -- obviously you don't want to spend too much and strand all this capital, but is there any risk that you could see quality suffer because you have pulled back so much on the EVDO side?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, we have been very careful over the years at managing that. We know our reputation is built on reliability, so it's a constant dialogue between Tony Melone as the corporate CTO and David Small and Dan Mead, but I think we feel like we are in a good place. Now you have to monitor it on a week-by-week basis and see how many devices and the usage, but that is what we are good at so I don't think we have any concerns.

**John Hodulik** - UBS - Analyst

And lastly on the CapEx, the level of LTE spending that you have now is that going to ramp as volumes grow or is this a level -- you say you have got a lot of capacity left, but are we at a good run rate here?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, when you build the network and you put your first couple of carriers in place you really have a very large, more or less, empty pipe. So it will take us a while to fill that up and then add the capacity to it from there.

So I think in this next year -- I don't think Fran has put out the capital spending but we are seeing it generally kind of flat play. Because remember in this process for Verizon we are beginning to wind down the FiOS spend as well, so I think generally we have got a good balance in the business.

**John Hodulik** - UBS - Analyst

And lastly on the wireless fundamentals, where does Wireless service revenue growth come from moving forward when you consider potential risks from third-party texting apps? This sort of feeds into the -- or third-party voice apps. Can we still expect accelerating growth from here?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, we think so but if I look back over my career there is always kind of the ebb and flow of products as they come, and that is where I use the stepping stone analogy with our team. So I do expect SMS to be under attack. You have seen that in some of the European countries.

We haven't seen as much of it, frankly, on our side but I think it's going to come. It's kind of like long-distance and the other stuff that you saw fade away. So our job is to add the next great thing to it and I think our announcement last week we added the next great thing to it.

So when you start doing all the video and you get some of these devices out there I think the next great thing beyond that that I alluded to is the machine-to-machine piece. All of the energy management, the healthcare stuff, the security aspects of it, I think that is the next step as well. So there will be an ebb and flow here and I think it's inevitable that some of those higher margin ones that have been around a while get picked off through the other parts of the ecosystem.

**John Hodulik** - UBS - Analyst

Maybe as a tangent to that the mobile payments has been something that, one, it has gotten a lot of press in just the last couple days. How important is that to the strategy, where we are in that process, and when can this potentially contribute to the top line?

**Lowell McAdam** - Verizon Communications - President & CEO

I think that is a great machine-to-machine, that is the way I think about it. So Dan just had the Board meeting with the Isis platform yesterday down in DC. They are prototyping now; buying Cokes and all the things that we have probably been talking about for 15 years is finally here.

So we do our first trials in the middle part of the year and based on everything we see in the roadmap that should be significant deployment by the end of next year. And then I think it becomes a real revenue stream for us in 2013.

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**John Hodulik** - UBS - Analyst

Okay, great. Now shifting gears onto the Wireline side, maybe you could start with the cost structure. Could you just give us an update on where the union negotiations are and how investors should think of Verizon's position and potential margin benefits?

**Lowell McAdam** - Verizon Communications - President & CEO

So there are two major areas that we have focused on with the union negotiations. The first is around the benefit structure and that gets a lot of the press. It's really not any different than what you see in state workers, New York City municipal workers.

We have a zero-dollar payment on healthcare and that just can't happen. We are not looking for thousands and thousands of dollars. We are looking to bring all of our unionized employees onto the same plans that we do the management employees, and that averages about \$100 a month. So I think that should be doable. It won't feel good to the union leadership but we have to have some changes there.

We have asked for some changes in the long-term benefit structure as well, retirement structure, especially for the newer employees. We have a moral contract, I would say, with the longer-term employees and so we are looking more for new employees that come in to change that structure.

But the bigger thing for me, or as big a thing for me, is some of the work rules. Because we have so many antiquated rules that govern how we can deploy the employees and, frankly, we put the customer in the middle of a bunch of silly policies. So we need to get those fixed so that we can streamline the operations.

Now that does have a significant impact to the bottom line from the business. If I don't have to dispatch two or three employees into a high-rise on the west side of New York City that saves some money. So I expect that to contribute to the bottom line of the business, but that is not the only thing. We have got a lot of other process improvement opportunities.

**John Hodulik** - UBS - Analyst

So I guess summing all of that up, before the storms we were seeing some nice sequential margin improvement for the last couple of years. Is that something we can expect and is the union negotiations a part of that?

**Lowell McAdam** - Verizon Communications - President & CEO

The union is a part of it, but I wouldn't lay it all at their feet because we use the term there are lots of pots of gold around the business. You go around and any large business you see, I call them dumb policies, that sort of creep into the business.

We have just instituted a lean Six Sigma approach to the business, very focused on the voice of the customer and trying to improve productivity, and you find things all over the place and procedures that you could improve. And so I think that will contribute to the bottom line.

So to answer your question, we did get hit by the storms that came in in the fall but we have recovered from those now. I think by the end of this quarter we will be kind of done with that. We are catching up on all of the volumes, the FiOS installs are going along nicely, so I do think we can get back on that trajectory of improved margins on the Wireline.

**John Hodulik** - UBS - Analyst

Some of the cable companies that were here earlier this week talked about tiered pricing in broadband and how some suggested you are going to see that in 2012 here. Given the strong data capabilities of FiOS, how does Verizon look at usage-based pricing?

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**Lowell McAdam** - Verizon Communications - President & CEO

It's not as big an issue for us in the home because the fiber into the home is such a large pipe that it's not taxing the network. Obviously, we have to look at the interoffice facilities and some of the backbones, but right now that is not something that is high on our to-do list for 2012.

**Lowell McAdam** - Verizon Communications - President & CEO

Now moving towards another topic that has also gotten some recent press just in the last 24 hours, the video business obviously is evolving it seems at a faster and faster rate. We got a lot of conversation about that here at the conference.

Maybe how do you see the ecosystem in terms of Apple, Google, and other over-the-top providers potentially changing the over-the-top model? And then, I guess to add to that, is there a place for Verizon in that ecosystem?

**Lowell McAdam** - Verizon Communications - President & CEO

So over-the-top, I do -- I think the jury is out but I do think there is a place for over-the-top here and it will be part of our strategy. There is lots of speculation about what we are going to do and what we are not going to do. That is all just speculation by people that like to write blogs.

We have looked at alternatives. When Hulu was on the market we kind of looked at that and we will continue to look at different alternatives, but I think there will be a place for over-the-top, but I also think there is a place for the video -- all the sports, the late-breaking things.

Now I think this opportunity that we have in front of us with Comcast, we get a chance to really tie into that and sort of be a hybrid, if you will, because we will be able to stream things and have live things, etc., if we can work out all the opportunities with the content companies. But I think that model has yet to be determined and I hope that we will be part of -- a big player in determining that.

**John Hodulik** - UBS - Analyst

Do you think over-the-top is more of a compliment to the existing or do already think over time streaming replaces what we think of today as linear video?

**Lowell McAdam** - Verizon Communications - President & CEO

I don't think it replaces it 100%. We have a tendency to see trends like this in the industry and extrapolate it to become the majority. I think it will be many years before it is, so I do think that the traditional FiOS broadcast will continue for a long time. But I think over-the-top can be complementary.

It's one of those things that I want to be positioned to transition and take advantage of it, but I don't think it's one or the other.

**John Hodulik** - UBS - Analyst

Getting back to FiOS, obviously your buildout is slowing a bit, ends over the next couple years. Talk about what you are doing to drive penetration into those existing homes faster.

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, I think we got a real gift with the FCC's report because we knew all along that we were performing better than our competitors and the FCC report really highlighted that. So that has helped us quite a bit. I know, as I have read other transcripts, you hear the traditional MSOs talk about FiOS taking share.

The big opportunity for us is the MDUs. If you go into New York, as an example, it has been one of our higher incremental penetration gain markets for us because we have gotten into these MDUs. And I think that will be a great opportunity for us.

And I do keep coming back to this, but as you sell this mobile video I think then you will have the competitive advantage where you will see penetration go up. So I think there is kind of three sources to penetration gains.

**John Hodulik** - UBS - Analyst

It seems like your major cable competitors will have the same products that you have -- Comcast and Time Warner Cable. So when you talk about penetration gains it sounds like it comes at the expense of the satellite providers. Is this JV basically an effort to get back share from those guys that might be somewhat disadvantaged because they don't have the terrestrial or wireless infrastructure?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, I think whoever is in the marketplace is going to have to figure out how to respond to this for sure. But I think that there are still a lot of people that either have satellite or one of the competitive products and FiOS's platform I think will perform extremely well. And as I said, you have got the ability to innovate on top of whatever we do so there will still be plenty of competition in the marketplace.

**John Hodulik** - UBS - Analyst

Given that, what is a reasonable -- you have done very well with FiOS, certainly penetration numbers higher than we expected them to be. So how high can they get over time?

**Lowell McAdam** - Verizon Communications - President & CEO

Well, we have got markets now that are 50% and so that is the rallying cry here. In Texas, which is the market we have been in the longest, the data penetration is just over 50% and the video penetration is just under 50%. So we have got a lot of markets that are in the mid-20% now so there is a lot of headroom for us to continue to grow.

**John Hodulik** - UBS - Analyst

Now switching gears to the business side. Can you talk about your enterprise cloud strategy and the impact on your growth outlook given the acquisitions of Terremark and CloudSwitch?

**Lowell McAdam** - Verizon Communications - President & CEO

Yes, boy, we are really pleased with the whole Terremark acquisition. They are helping us raise our game overall with our data center infrastructure and cloud. There is just a terrific team down there that is focused on the government and the large enterprise.

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We have a center that we opened in Hong Kong this last year. We have got -- we just opened one in Amsterdam a few months ago. I mean just top-of-the-line facilities and Terremark and the team are doing a very good job selling into those. Sometimes we are worried it's coming a little bit faster than we can keep up with it. So we are very pleased with that.

CloudSwitch complements that well because it makes it easier for customers to move their services into the cloud. If I think about -- about 18 months ago we had a Customer Advisory Board in Charlotte and all of the customers there, I would say maybe 10% to 20% said we would be very interested in the cloud. The rest of them said, no, I am going to do this myself. I am not going to trust my -- it has almost flipped 180 now. 80% are saying we would love to put our stuff into your cloud.

And I think the economy, in a perverse way, has helped that because they see there is an advantage to cut their costs by leveraging our scale and our infrastructure versus doing it themselves. So our task now is to drive that into the major businesses as well. So while the Terremark asset is going to spend time on the enterprise and the federal government, we have got the rest of our Verizon Business team now working to drive that into the major business side. And we think that could actually be even more opportunity for us than the enterprise side.

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**John Hodulik** - UBS - Analyst

As it relates to the enterprise and the business market in general, are you seeing any -- it looks like unemployment is starting to come down. Are you seeing any sort of new potential tailwinds emerging as it relates to the economy?

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**Lowell McAdam** - Verizon Communications - President & CEO

I wish I could say we are, but I don't think we are. I mean it's still kind of bumping along and I personally don't expect a lot of difference between now and the elections. The position that we are in as Verizon is actually insulating us a little bit because FIOS is so strong, because the cloud is a relatively new product, because LTE is a relatively new product, because opportunity here with Comcast I think and SpectrumCo.

I think we see the things that we can build on that sort of insulate us from the ups and downs of the economy. But I have to say underneath it I don't see a lot of, what they call it, green shoots or something was what we used to say.

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**John Hodulik** - UBS - Analyst

Okay. Maybe just quickly on the regulatory front, net neutrality were big issues the last couple of years. Most recently we have had the FCC action on USF and intercarrier compensation reform. Any of those affect the industry or Verizon in any way we should be aware?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, I think let's deal with those in the opposite order here. So I think that the USF is terrific. My hat is off to Chairman Genachowski for working that issue. Gosh, if you look at the -- the rate this quarter will be 17% and most of that was going to subsidize voice. That just seems to be so counterintuitive to what the administration is trying to get done about getting broadband out into the rural markets.

As you know, John, we championed the rural LTE strategy where we took and for next to nothing licensed our C Block to the rural carriers so that they could get LTE up and get broadband out there. So I think this whole USF reform starts to move in that direction, so that is a very positive thing.

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On the net neutrality front, obviously we are concerned about it. We filed a lawsuit about it. It isn't the principles of net neutrality as it aligns with managing the Internet.

The order went way, way beyond that from our perspective into areas that the FCC doesn't really have any authority and that is to get into to start regulate broadband and broadband pricing and those other relationships that we think belong in the commercial market. So we felt we had to challenge it.

And I do think that if we are successful I think the ecosystem continues to thrive. If we don't, I think all the uncertainty associated with regulation creeps in and I think it could have a negative impact on the industry.

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**John Hodulik** - UBS - Analyst

Okay. Two things just before we turn it over to the audience for questions. First, uses of cash.

Obviously you have got the payment for the spectrum, \$10 billion check you need to write or at least you are obviously going to see a big part of that from the parent standpoint. Obviously the dividend is a central part to Verizon and Verizon shareholders. What can we expect with excess cash flow beyond that? Paying down additional debt, maybe more -- I think you gave us some good insight into the capital spending going forward, but is there any other potentially shareholder-friendly uses of cash that we can expect in the next --?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, I think the question always comes up about what do you do with the cash that accumulates within Verizon wireless. We are going to look for opportunities like the spectrum to use that, but we are going to be good stewards of the cash. Having a bunch of it sit on the balance sheet at Verizon Wireless is probably not something that we think makes sense and our shareholders would think make sense either.

So we will pay down debt. I think long term we could look at share buybacks. We will distribute what we need to and Vodafone has been a great partner and certainly deserves a return, so when it's the right thing to do we will return that as well. So it's not a big -- to me it's a very factual, logical analysis of what the best use of the cash is.

I always like to look for investments to grow the business and when I can do that I am going to do that, but if we don't see something good in front of us then we will distribute it out.

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**John Hodulik** - UBS - Analyst

Makes sense. Actually with that we can take some questions from the audience. We have got about 10 minutes and there is some mics moving around. Start off right here.

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## QUESTIONS AND ANSWERS

### Unidentified Audience Member

Just a quick question. Was trying to get -- or a couple questions. On the 70% for smartphones here in the states, when do you think that might be achievable? And on 4G I was just trying to get an idea of the level of penetration amongst your subscribers. Is there a percentage of your subscribers that are 4G at this point?

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Just lastly, was just trying to get an idea as far as -- you mentioned possibly having to strand 3G at some point in the future. I wasn't sure how far out on the horizon that might become an issue as far as having some 3G stranded at some point. I just wasn't sure when that becomes an issue.

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**Lowell McAdam** - Verizon Communications - President & CEO

So you may have to remember remind me of those; you managed to sneak a couple good ones in there. So on 3G I think the point is we are trying to make sure we don't strand a lot of investment there, and that is why moving people over to 4G is critical for us.

I think a lot of the new products that come along, like the machine-to-machine stuff, a lot of the healthcare, and the security, and that sort of thing can certainly ride 3G, so we have got plans to fill up that network. But I don't want to overbuild is the key.

Your question about 4G; it's really too early to talk about penetration and ARPU levels and those sorts of things. But we think that it will be at least as good as 3G, more than likely stronger because of the applications that you can provide.

And your first one was --?

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**Unidentified Audience Member**

(inaudible - microphone inaccessible)

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**Lowell McAdam** - Verizon Communications - President & CEO

Oh, yes, the 70%. To me that is driven totally by the kind of applications that we bring and some of the devices. I don't think you are going to see that in the next couple of years, but certainly three, four, five years out.

The more we bring these video applications to bear the more people are going to want to have the big screens. So I think a little bit of that is in our own hands and how successful we are at developing these kinds of products.

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**John Hodulik** - UBS - Analyst

So, Lowell, it seems that these applications are going to drive video and usage. Does that eventually get us to a point where usage-based pricing starts to be increasingly accretive to ARPU?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, I think so. I mean a little bit depends on what goes on in the industry and you asked -- one of your first questions was how many people build out LTE right away. I think Verizon has always been in the position where it tries to price at a premium to the rest of the network. Then that depends on what the other networks do in this process.

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**Unidentified Audience Member**

I have a follow-up on FiOS if I may. I recall you saying that you are slowing down CapEx a little bit, but on the other hand there is tremendous pent-up demand, as you mentioned, in places like Manhattan where you have you MDUs. You have set a good place of additions.

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I am not looking at all for quarterly guidance, but if you look out perhaps three or five years where do you think you will sell at in terms of penetration of these markets where there is a lot of cable operators -- Comcast, Time Warner, Cablevision? Do you think it's a 50/50 kind of a split we are going to see over time between you and the cable guys?

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**Lowell McAdam** - Verizon Communications - President & CEO

Well, that would certainly be our objective to get around that 50% penetration across all of our markets. With FiOS we are about 16 million POPs at this point and we want to get to about 18 million. If we built out the whole footprint, we would be more in the 21 million, maybe a little bit more, range.

But I don't plan on going any further than we have talked about because we have got to kind of clean up a few of the processes around the ONTs. We have now developed a strategy whereas if we put FiOS down the street, regardless of the services that are on the street we are going to move everything over to FiOS and get the copper out of service and out of our base. So that is a pretty significant shift for us.

That changes the scale and, frankly, the cost structure associated with FiOS. If I can get some rhythm on that and be a little bit more efficient on the ONTs and what goes on inside the house then the economics of FiOS begins to get better and better then I can reevaluate. But for now the bottom line is we are going to build out what we said and not any more.

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**John Hodulik** - UBS - Analyst

If we could just follow up on that new strategy, is that something that starts in 2012?

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**Lowell McAdam** - Verizon Communications - President & CEO

Yes.

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**John Hodulik** - UBS - Analyst

I guess that would involve putting an ONT in every current customer home regardless of whether they take FiOS services or not.

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**Lowell McAdam** - Verizon Communications - President & CEO

But not necessarily the current ONT. So there are two big aspects to that and Tony Melone is driving this. Today inside the house you have to do everything over coax. We believe that you can do the things that you need to do inside the house over a modified WiFi or a standard WiFi, which dramatically changes your expense of install.

We also think that you can go with a very small modular optical box if you are doing just data or you are doing voice and data inside the house and only do the bigger one when you do video. So I think you do just those two things, one on hardware and one on the communication inside the house, really changes things.

Then, as I said, if you start moving all of your services over onto the FiOS instead of just the data service and the video service, you spread that investment; we can take other pieces of the network down. So it changes our approach. So we expect to be moving pretty swiftly toward that in 2012.

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**John Hodulik** - UBS - Analyst

I am not sure you -- I don't know if you want to talk about an end date, but if you are talking about 16 million, 17 million homes what kind of timeframe should we be looking at before you guys are completely through this?

**Lowell McAdam** - Verizon Communications - President & CEO

Yes, I think internally it's over the next couple of years, but there is a long tail on this sort of thing. A little bit depends on how do we progress with the technology changes I just mentioned. A little bit depends on how we are doing in managing our overall capital budget, are we getting good returns on that, and so we we'll modify. But I think it's a couple of years to at the most four years is probably the plan.

**John Hodulik** - UBS - Analyst

And then I guess just lastly, finish on this, you brought up the topic of CapEx in terms of (inaudible). Is this going to entail some increased levels of spending on the Wireline side as we move through this process?

**Lowell McAdam** - Verizon Communications - President & CEO

No, no, I don't think so.

**John Hodulik** - UBS - Analyst

And then I guess also, should we start to see the margin improvement on a ratable basis?

**Lowell McAdam** - Verizon Communications - President & CEO

Yes, and that is part of -- when you asked the question on the improvement in Wireline margins that is all part of it. So it's the work rules, it's the benefits, it's the union contract, it's a bunch of process improvement, and it's some technology innovations.

One other one Tony Melone is working on is we have got really four different IP backbones that cover the US. With a little investment we get to combine those into one much bigger pipe; we will be much more efficient. So we will spend a little bit of capital in the short run and we will have a much better return in the long run. So those are the sort of architectural things that I think will help the bottom line.

**John Hodulik** - UBS - Analyst

Any other questions? We got time for two more questions. One here and then one here.

**Unidentified Audience Member**

So I hope I don't stunt the other guy. One, on the electronic wallet, the question I have for you how are you going to derive the revenues? In other words, how are you going to get paid?

There was an article in The Journal today, I am sure if you didn't read it you will read it, about how Google wants to get paid. How do you guys want to derive your revenues?

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**Lowell McAdam** - Verizon Communications - President & CEO

It's mostly hosting and transaction fees, those are the two, so the concepts aren't an awful lot different than Google's from that perspective. The banks -- I think the banks partners can win, I think the merchant can win, and we will see those hosting and transaction fees.

**Unidentified Audience Member**

And the second question is you mentioned that you are somewhat immune from maybe an economic slowdown because of all the exciting things you guys have in the pipeline. I don't know if you give guidance on top line or not, but if you are, as an investor, what should we look for in the next couple years assuming no super recession and no super pickup, 1% to 3% growth? What do you guys think you will grow your top line at?

**Lowell McAdam** - Verizon Communications - President & CEO

I don't think we are giving any guidance on that. Fran will probably, as we do our fourth-quarter results, give a little bit of a view into 2012, but I think at this point we are probably not ready to say much.

**John Hodulik** - UBS - Analyst

Okay, last question here in the front.

**Unidentified Audience Member**

You recently released the DROID RAZR and the HTC Rezound, those seem to be really selling really well. I wanted to know in terms of products for 2012 and technology what are you really psyched about beyond the 4G and LTE.

**Lowell McAdam** - Verizon Communications - President & CEO

Yes, the RAZR, by the way, is a very -- as long as you give me that lead in I will pull it off my belt here. But if you haven't seen it, it's a huge -- they made me turn it off but it's a huge screen, very thin device, great battery life on it. I have been using it for a couple of months now and I think it's terrific.

So what am I getting excited about? I am beginning to see the tablets really take off and some good integration between the tablets and the smartphones. You will see more of that as we roll out these products, but those are getting me excited.

Now I will also tell you that I am finally seeing machine-to-machine apps that you start going, okay, this is cool; I could really use this. A lot of healthcare; we have met with a lot of medical professionals around the country and some great ideas. There was a great article about the Human Genome Project and why you need strong networks and why you need tablet and smartphone devices that we are going to be offering.

So I think there is a number of those that kind of get me excited over the next couple of years.

**John Hodulik** - UBS - Analyst

Great. That is all we have time for today. Lowell, thank you for coming.

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**Lowell McAdam** - Verizon Communications - President & CEO

John, thank you.

**John Hodulik** - UBS - Analyst

Appreciate it.

**Lowell McAdam** - Verizon Communications - President & CEO

Thank you all.

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