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VZ - Q2 2017 Verizon Communications Inc Earnings Call

EVENT DATE/TIME: JULY 27, 2017 / 12:30PM GMT



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## PRESENTATION

### Operator

Good morning, and welcome to the Verizon Second Quarter 2017 Earnings Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

It is now my pleasure to turn the call over to your host, Mr. Michael Stefanski, Senior Vice President, Investor Relations.

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**Mike Stefanski** - *Verizon Communications Inc. - SVP of IR*

Thanks, Eunice. Good morning, and welcome to our Second Quarter Earnings Conference Call. This is Mike Stefanski, and I'm here with Matt Ellis, our Executive Vice President and Chief Financial Officer.

As a reminder, our earnings release, financial and operating information and the presentation slides are available on our Investor Relations website. A replay and a transcript of this call will also be made available on our website.

Before I get started, I would like to draw your attention to our safe harbor statement on Slide 2. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. Discussion of factors that may affect future results is contained in Verizon's filings with the SEC, which are available on our website.

This presentation contains certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are included in the financial materials we have posted on our website.

The quarterly growth rates disclosed in our presentation slides and during our formal remarks are on a year-over-year basis, unless otherwise noted as sequential.



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Before Matt goes through the results, I'd like to highlight a few items. For the second quarter of 2017, we reported earnings of \$1.07 per share on a GAAP basis. These reported results include a few special items that I would like to highlight. Our reported earnings include a net pretax gain of about \$1.8 billion. This net gain consists primarily of the sale of certain data centers to Equinix. We also incurred pretax severance charges of \$607 million, and acquisition- and integration-related charges of \$152 million, primarily in connection with the closing of our acquisition of Yahoo's operating assets, which we've previously disclosed.

The net impact of these items after tax was approximately \$458 million, or \$0.11 per share. Excluding the effect of these special items, adjusted earnings per share was \$0.96 in the second quarter compared to \$0.94 a year ago. As a reminder, last year's adjusted earnings per share included \$0.07 from the impact of the work stoppage.

Also our consolidated results for the second quarter included one month of data center operations that we sold to Equinix on May 1, 2017, and about 2 weeks of Yahoo operations. We have posted unaudited historical wireline segment results, which recast the segment for the impact of the sale to Equinix on our website.

With that, I'll now turn the call over to Matt.

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### **Matt Ellis** - Verizon Communications Inc. - CFO and EVP

Thanks, Mike. Good morning to everyone on the call, and thank you for joining us today. We had a strong quarter of execution.

First, we invested in our 4G network leadership position, resulting in a sweep of third-party network performance surveys for the first half of 2017, while prepositioning for 5G services.

Second, we delivered solid wireless operational performance and financial results in a competitive environment with an increase in both postpaid and prepaid accounts.

Third, we successfully completed the acquisition of Yahoo's operating assets to scale our media business.

Network leadership is the central element of our strategy, and we are continually investing in our network to extend our leadership in 4G capacity growth with densification using small cells, which includes expanding our fiber capabilities. As we prepare for the network of the future, we announced the acquisition of Straight Path for \$3.1 billion, which we expect will close by the end of first quarter 2018. Straight Path complements our spectrum portfolio and positions us to lead and further drive 5G technology and its ecosystem. We have begun the pre-commercial fixed wireless trials in 8 out of the 11 markets and have our first batch of customers on this technology. As we have previously highlighted, we will have trial results later in the year, and I look forward to sharing them with you.

We had a strong quarter adding and retaining wireless customers as the momentum from the launch of our unlimited plans was sustained throughout the quarter. We delivered a strong wireless operational performance that reflects customer demand for our high-quality network in a highly competitive market.

Finally, we completed the acquisition of Yahoo's operating assets and immediately began executing on integration plans that we've been working on for over a year. We are confident in the execution of our strategy, which we expect to drive profitable growth, generate strong cash flows and return long-term value to our shareholders.

Let's go deeper into the second quarter operating performance at the consolidated level, followed by wireless and wireline results, media and telematics progress, and network and technology updates.

Now on to Slide 6. In the second quarter, total operating revenue was in line with last year. On a comparable basis, excluding divestitures and acquisitions, consolidated revenue declined 2.0%. The primary driver was the decrease in wireless service revenue, which was consistent with our expectation. On a consolidated basis, excluding special items, adjusted EBITDA margin was 37.2%.



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We remain focused on improving our overall cost structure through operating efficiencies across network, distribution and care. As we shift more transactions toward a digital model, we can improve the customer experience and further enhance operating efficiencies.

Let's turn now to cash flows and the balance sheet on Slide 7. Our operating segments continue to generate substantial cash flows. During the first half of 2017, cash flow from operating activities totaled \$9.9 billion and included a net after-tax discretionary pension contribution of \$2.1 billion. Our high-quality cash generation is driven by the diverse base of wireless and wireline customers. Our ongoing asset-backed securitization program provided \$2.9 billion of cash, which flows through the financing section of the cash flow statement. The impact of the transition to device payment plans and on balance sheet securitization should approach a steady state around the end of 2017. Thereafter, the sequential impacts will primarily reflect seasonality of new device launches. As a result, we expect working capital headwind to subside in 2018.

For the first half of the year, capital spending was \$7.0 billion, which is in line with last year. On a year-to-date basis, our reported free cash flow of \$2.9 billion includes the discretionary pension contribution, net of tax, of \$2.1 billion, which flowed through our cash flow from operations. In addition, our free cash flow does not include proceeds from asset-backed securitization, which was introduced in the third quarter of last year.

Our balance sheet is solid and provides us with financial flexibility to grow the business. We ended the quarter with \$117.5 billion of total debt, which comprised of \$109.6 billion of unsecured debt and \$7.9 billion of on-balance sheet securitizations.

We have not changed our capital allocation plan or our expectation for cash availability. And we remain focused on having a strong balance sheet with improving credit metrics, while continuing to invest in our businesses and returning value to our shareholders.

Now let's move into reviews of the operating segment, starting with wireless on Slide 8. In a highly competitive wireless environment, we delivered a strong operational performance protecting and expanding our high-valued postpaid customer relationships, while balancing profitability. With a clear and comparable offer, our value proposition highlighted the strength of our network, resulting in industry-leading customer retention and improved new demand during the quarter as our offer appealed to customers in underpenetrated segments.

Wireless operational performance was sustained throughout the second quarter, building on the customer momentum at the end of the first quarter with improvements in both sequential and year-over-year net phone add performance. Net phone additions were 358,000 compared to 86,000 in the prior year. Smartphone net additions were 590,000 versus 336,000 last year. Postpaid net adds totaled 614,000, including tablet net adds of 2,000 and other connected devices of 254,000, led by Verizon Wireless retail hum devices. We added 64,000 postpaid accounts versus a loss of 83,000 last year. And we grew our postpaid account base for the first time in the past 6 quarters.

Our postpaid phone churn reflects customer demand for network quality and reliability, while pricing provided choices to meet customer needs. Postpaid phone churn not only continued recent trends below 0.9%, but also established a new low in the LTE era at 0.70%. Total retail postpaid churn of 0.94% was consistent year-over-year and down 21 basis points sequentially.

Total postpaid device activations were up 3.0%, of which 82% were phones. Our retail postpaid upgrade rate was 5.6%, up from 5.4% year-over-year and was 43 basis points higher sequentially. During the quarter, 6.2 million phones were activated on device payment plans.

Prepaid net adds of 19,000 were up year-over-year and sequentially due to our stronger value proposition.

Let's turn to Slide 9 and take a closer look at wireless revenue and profitability. Total wireless operating revenue declined 1.9% in the second quarter as compared to a 5.1% decline in the first quarter. Service revenue declined 6.7% versus a 6.1% decrease in the previous quarter. This trend was primarily due to the lost overage revenue, driven by plans introduced during summer of 2016 and the introductory unlimited offer. As we discussed during our last earnings call, we expected weaker year-over-year service revenue through the first half of the year, primarily due to line access and overage revenue trends. At the end of the second quarter, about 59% of our accounts have tools that offer customers the ability to self-manage their usage experience.

During the second quarter, we experienced an improvement in the rate of decline in line access revenue as we now have roughly 75% of the postpaid phone base on unsubsidized plans. We expect this trend will continue, which, combined with adding new accounts and migrating



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customers to higher access points, will mitigate the lost overage revenue. Therefore, we believe the service revenue trend has flattened. And we expect that there will be an improving trend in the second half and we should exit the fourth quarter inside a decline of 4.0%.

In the second quarter, equipment revenue increased 16%. The percentage of phone activations on device payment plans was about 77% in the quarter as compared to approximately 76% in the first quarter. We expect the take rate for device payment plans for the third quarter to be consistent with recent experience. Approximately 49% of our postpaid phone customers had a device payment plan at the end of the quarter.

Our wireless EBITDA margin, as a percent of total revenue, was 45.8%. The movement in the service revenue trend will also positively impact wireless EBITDA margin.

Let's move next to our wireline segment on Slide 10. Total wireline revenue on a reported basis grew 1.2%, including the recently acquired XO operations. On an organic basis, wireline segment revenue decreased 2.8% compared to a decline of 3.2% last quarter. The shift in the wireline revenue trend towards fiber is growing. Organically, fiber-based products grew more than 3%, which supports our plans to further invest in fiber.

Our emphasis on delivering value to all business customers from the very small to the large enterprise was recognized recently in a leading third-party study. More importantly, we won the large enterprise business award for the second consecutive year in the same study.

Consumer markets revenue increased 0.6%, driven by Fios Internet activity. Consumer Fios revenue growth of 4.1% was consistent with the past several quarters. During the quarter, we launched Fios Gigabit Connection in certain markets, which offers symmetrical speeds of up to 1 gigabit per second. In Fios Internet, we added 49,000 customers. Fios Video results were pressured due to softer secular demand for traditional linear video, given growth in the over-the-top offerings as well as competitive promotional activity. Fios Video losses were 15,000 in the quarter.

For the second quarter, enterprise solutions revenue fell 4.1% on an organic basis, which was due to persistent trends in our legacy products and pricing compression in the marketplace. On a constant currency basis, revenue was down 3.5%.

Partner solutions revenue declined 6.8% on an organic basis, while the revenue mix towards fiber has been trending higher. Within business markets, fiber revenue is expanding, driven by Fios broadband demand, offset by continued pressure in legacy products. On an organic basis, revenue declined 4.9% and improved slightly sequentially.

On a comparable basis, the second quarter wireline EBITDA margin was 20.8% compared to 13.3%, which includes the work stoppage last year. Sequentially, wireline EBITDA margin was down 120 basis points, primarily due to lower revenue from enterprise solutions and partner solutions and an increase in operating expense as a result of leasing data center space related to the sale to Equinix.

Let's move next to Slide 11 to discuss our progress in new businesses, starting with media. On June 13, we completed the acquisition of Yahoo's operating assets. Upon closing, we launched Oath, which is a combination of AOL and Yahoo brands, serving approximately 1 billion unique monthly users globally and currently represents about \$7 billion in annual revenue. We have been planning the integration of AOL and Yahoo for the past year and immediately began executing on integration plans upon closing. We expect to realize over \$1 billion in cumulative operating expense synergies through 2020.

We are in the very early stages of leveraging the scale of the combined assets to distribute and monetize content through programmatic advertising across our sports, finance, news and entertainment properties. These properties will provide unique advertising opportunities to targeted global audiences.

Organically, AOL's revenue, net of traffic acquisition costs, was consistent with prior year's results in the quarter. As the integration progresses, we will provide additional information on the Oath business.

Organically, IoT revenue, including telematics, increased approximately 20% in the second quarter. Telematics' revenue was approximately \$220 million in the quarter.



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Let's move next to Slide 12 to discuss network and technology. We consistently invest in our wireless and wireline assets to ensure that we have capacity, reduce the cost to serve and to preposition the networks for the future. Our value proposition to our wireless customers is to provide a full network experience, including reliability, coverage and speed. We are on our wireless network plan to deliver the industry's best overall experience for our customers. Our network experience continues to be recognized by multiple third-party studies as the industry leader. Since the launch of Unlimited, 2 of these studies have reconfirmed our network leadership in overall performance, including speed and voice quality over LTE. As expected, the introduction of the Unlimited pricing plan increased the LTE network usage as our customers enjoy the experience of consuming more data throughout the day on the industry-leading wireless network. We are confident in our network and have been engineering the network based on a long-term integrated plan to extend our high-quality experience, while expanding our value proposition for customers. We remain focused on delivering an increasing capacity over the long term, utilizing a 3-pronged approach: first, network features; second, densification; and third, spectrum. Let's discuss each of these in detail.

First, we are methodically deploying LTE advanced features to increase capacity on our network resources and align with the timing of smartphone introductions that can take advantage of these features.

Second, small cells are playing a vital role in creating capacity. The densification efforts have been a focal point of our network strategy over the past several years. This density also creates increased spectral efficiency and offers the best wireless experience.

Finally, with nearly all of our network traffic now on the 4G LTE advanced network, we are utilizing just over 50% of our low- and mid-band spectrum portfolio for this network. We expect to use more of our PCS spectrum for LTE and are just beginning to redeploy 850 megahertz spectrum in certain markets.

In addition, we are deploying AWS-3 and will start to add unlicensed spectrum later this year. Our spectrum deployments, in conjunction with multi-carrier aggregation technology, are enabling us to increase network capacity.

Our overall wireless network integrates features, densification and spectrum to enable a step function increase in wireless network capacity over the long term.

Fiber is a critical element in transforming both wireless and wireline networks to reduce cost and expand future capabilities. To enhance this strategy, our recent announcements to secure fiber demonstrates our commitment to increase our multiuse fiber footprint and build fiber deeper into the network.

On the 5G wireless front, we are up and running in 8 out of the 11 pre-commercial fixed wireless broadband trials on the millimeter wave spectrum. We have the first batch of customers on the network. We will have trial results towards the end of the year that will give us valuable insights for commercial deployments.

Let's move next to Slide 13 to review our strategy for future growth. We are executing on our plan to lead in network, preserve and grow our customer relationships and expand our presence in digital media and telematics to deliver fundamental results, while allocating capital to continue to invest in our operations and return value to our shareholders. We delivered strong wireless operational performance and financial results in a competitive environment. We evolved our wireless value proposition, while driving profitable growth and reconfirming network leadership based on third-party study results. We expect that we will create incremental capital and operational efficiencies that result in additional cash generation.

Our 5G strategy is progressing for fixed and mobility use cases, standards, spectrum resources and fiber investments. Now that we have completed the acquisition of Yahoo's operating assets and introduced the Oath brand, our media business is focused on the integration plans and will look to increase engagement on our platforms.

In telematics, we see additional growth opportunities with our Fleetmatics and Telogis assets. We remain confident in our strategy, which puts us in a strong position to compete today and into the future, while delivering long-term value to our shareholders.

With that, I will turn the call back to Mike, so we can get to your questions.



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**Mike Stefanski** - Verizon Communications Inc. - SVP of IR

Thank you, Matt. Eunice, we're now ready to take questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from Mike Rollins of Citigroup.

**Michael Rollins** - Citigroup Inc, Research Division - MD and U.S. Telecoms Analyst

Two questions, if I could. One is curious if you could delve a little bit further into the competitive environment. Last earnings call, you provided a perspective of how net adds and gross adds flowed over the quarter. I was wondering if you could do the same thing just so we could frame what was driving the improvement in your performance this quarter on the phone add side of the equation. And then secondly, just on 5G, if you can give us an update where you are with trials and maybe if you have update on the economics that you're seeing from those deployments.

**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

Thanks, Mike. Appreciate the questions. So on the competitive environment through the quarter, I would say we saw that it -- our performance in the quarter was pretty even. You saw the churn number, we came in at 0.70%. That certainly contributed to the net adds and shows that once we had a comparable offer out there against the competition, I mean, by being unlimited where the other guys were unlimited, even with the price premium we have, it shows that customers value the high-quality network experience that we deliver. And we saw that as we -- throughout the quarter. So even as we headed into the back end of the quarter and the competitive environment picked up and some of the other offers that came out there, whether that be large bounties to switch carrier or offering free service, our performance in the back end of the quarter was consistent with where we saw in the first part of the quarter. So we saw a great result from customers on both the gross adds side and the loyalty side once they had that comparable offer to do. So very excited about how that played out. As we head forward, second quarter is typically seasonally the low quarter for churn. So while we certainly expect churn to continue to be at low levels, we'll see if we get normal seasonal uptick as we go forward. But from a competitive environment standpoint, I think we showed that we competed throughout the quarter without having to put any aggressive promotions in place in the market at any time during the quarter. In terms of 5G, I think, as I said in the prepared remarks, we now have the trials up and running. It's going to be later in the year before we start to see results out of those trials. And then in terms of the business model and economics that may come out of that, it will be driven by the results we see from the trials. So too early right now to be more definitive on that, but we're still confident that we'll have a commercial product in market during 2018 and look forward to providing more details on what's coming out of the trials and the overall economics that we see when we get into the latter part of the year.

### Operator

Your next question comes from Phil Cusick of JPMorgan.

**Philip Cusick** - JP Morgan Chase & Co, Research Division - MD and Senior Analyst

First, can we talk about your small cell rollout? Where are we in the path of that? I know it's a multiyear effort, but how far are we into the small cell rollout and densification? And second, can you talk about the competitive environment in video and broadband? As you add up the OTT trends and traditional video losses, do you see an acceleration in cord cutting? Or does it just seem like customers are spreading out among more video service providers?





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**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

Yes. Thanks, Phil. So on the small cell rollout, we're exactly where we planned to be. I mean, our capital plan for the year, we're right on where we plan to be at the start of the year. And we are now -- I would say, we have small cell builds in all of the top metro markets at this point. And that's one of the reasons we have the network performance that we've had. We saw confirmation of that as recently as yesterday with another one of the third-party surveys that proves that during the first quarter of '17. Even once we are on unlimited, our network performs better than anybody else's, and that's in large part due to what we've been doing for the past number of years on small cell densification. I know you hear a lot of other people talk a lot about small cell densification now. Remember that we've been doing that for a longer time period than anyone else. And that's why we're in all of the top metro markets, and we will continue to do that. That will be a continued part of our network capacity plan. As we talked about in the prepared remarks, we have the long-term network plan that's based off continuing to deploy the spectrum that we own against the LTE network, densification and the LTE tools that are available. So densification continues to be a very important part of our network plan. From a competitive environment in the broadband and TV space, I think what you saw is we had a continued strong performance on the broadband side, but we also see the ongoing secular trend around video. So we continued to add high-quality broadband customers. And we'll continue to compete on the video side. But certainly, we do that in the face of the secular trends that are ongoing.

**Philip Cusick** - JP Morgan Chase & Co, Research Division - MD and Senior Analyst

Is there a point, Matt, at which the small cell densification efforts sort of starts to slow down in a few years? Or is this a constant effort for the next 3, 5 years?

**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

I think it continues. And it's not just around 4G. If you -- as we've talked in the past, as we see 5G being deployed on millimeter wave spectrum, that's going to require small cell deployment. And so as we put the densification in place of 4G, we're doing it in mind knowing that we've got the 5G that will be put to use in the same dark fiber and other assets. So the densification activity will continue here for a good number of years.

**Operator**

Your next question comes from John Hodulik of UBS.

**John Hodulik** - UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group, and Telco and Pay TV Analyst

Matt, maybe can we get some more color on a couple of the forward-looking sort of items you gave us on the wireless side? First, on the service revenue, it was down 6.7%, but you said it would start to sort of flatten in the second half. So that -- so can I assume -- and then the 4% sort of year-end exit run rate, can I assume we're looking at something around 6.7% for the third quarter and then improvement is something in the sort of 5% range for the fourth quarter? Just if we could get some color there. And then similarly, on the margins, you said as the service revenue improved, we'll see some improvement in the margins. Total margins on wireless have been down a little bit in the first half on each quarter. Does that mean -- are you sort of suggesting it will be down less in the second half? Or do you think that, as we see the improvement into the year, obviously, there are some crosscurrents with the new phone, but can we get back at flat or even positive comps on the margin?

**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

Yes. Thanks, John. So on the service revenue, I think consistent with what we've said earlier in the year, we see second quarter as being the low point. And the 6.7% for 2Q will become something better than in the 3Q. And in my prepared remarks, I believe I -- you heard me say that we'll be inside of negative 4% in the fourth quarter. So in terms of the -- how do we get there, we talked about that 75% of the base in the second quarter





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was on unsubsidized pricing. That compares to 53% a year ago. So there's north of a 20-point movement from second quarter last year to second quarter this year. As you get into the back half of the year, I'll use fourth quarter as an example, fourth quarter a year ago, that number was 67%. That -- this year, that number is going to top out in the upper 70s. So we're at 75% now. We'll get up to, let's say, 77%. That will only be a 10-point delta in the fourth quarter year-over-year. So that pressure that's come from taking customers from the subsidized model down to the unsubsidized pricing is starting to wane. And really, the second quarter is where we've reached the point we've got essentially the vast majority of the consumer base now on unsubsidized pricing. And then overage revenues also being part of the -- obviously, part of the story here over the past few quarters. First, with the introduction of the price plans last year that had the safety mode feature and then bring on unlimited, as we said, we now have 59% of accounts on 1 of those 2 plans. Overage was actually down 34% in the second quarter on a year-over-year basis. And it now represents a low single-digit percentage part of total service revenue. So we're working through that headwind. We'll work through that headwind a lot faster. And so as I say, based off that, I am very confident we'll be inside 4%, negative 4% in fourth quarter. And by the time we get on this call a year from now and our comparison is against this year being 75% on unsubsidized pricing, we'll be having a very different conversation about the service revenue trajectory next year. And then on margin improvement, as you know, service revenue is the highest margin component of our business. So as the trajectory on service revenue improves, the trajectory on margin will improve as well.

**Operator**

Your next question comes from David Barden of Bank of America Merrill Lynch.

**David Barden** - BofA Merrill Lynch, Research Division - MD

I guess, 2, if I could. I just wanted to follow up on that service revenue question. Matt, I mean, the math kind of suggests that by fourth quarter, your service revenue will actually be growing from where it is in the second quarter. And I wonder if you could kind of talk about the inputs to that expectation in terms of the kind of what you expect from a competitive pricing environment, promotions with the iPhone, et cetera, relative to that mix shift that you've been talking about as you kind of go past the price down cohort and you move into this group of people that are kind of more pricing up. If you could talk about those 2 dynamics this kind of inputs as your base case, it will be helpful. And then the second question, if I could, would be on the media segment. I mean, if you could kind of elaborate a little bit more on what is that thing growing at today and what will it look like in the future. I guess, we've talked about maybe turning down the search business and how that business might transform over the next 6 months or a year, kind of be helpful to kind of understand what that unit is going to look like.

**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

Yes, David. Thank you. So the inputs to service revenue, really, if you think about that trajectory changing, when you've got growing accounts, growing net adds, when you see the continued improvement in the delta on the nonsubsidized pricing and as we work through the overage, all of that will combine to a much stronger trend as we go forward from where we have been. In terms of the impact of any new devices coming along, we assume that we'll see something later in the year. We typically are -- have very strong results when we have new devices come out because when customers get a new device with new functions, they want it on the best network, but we'll see what happens there. And certainly, we'd expect that to be accretive to the overall revenue story. But our guidance for the year doesn't require any major uplift as a result of that. And then the media side, look, I will say it was very early in the process of integrating those 2 businesses. As we've said, the revenue of AOL less TAC was flat year-over-year in the quarter. Tim and the team are just getting started integrating those 2 businesses. They're about 45 days in at this point. The integration is going well. And I look forward to being able to provide more color and commentary about exactly what they're seeing as they go forward. But as you heard Tim say a couple of months ago, the goal here is to grow this to north of \$10 billion in revenue by 2020. And nothing that's happened since we closed has changed our view on that.

**Operator**

Your next question comes from Brett Feldman of Goldman Sachs.



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**Brett Feldman** - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

A question for Matt. And if I'm reading your guidance correctly, it seems like you effectively reiterated your outlook for the year, including what implies roughly a flattish EPS trend. There were a few moving parts this quarter. You did the Equinix data center deal, and I think that may have been slightly dilutive to earnings. And of course, you completed the acquisition of Yahoo. So I was hoping maybe you could just unpack your outlook for the full year and maybe let us know the extent to which those transactions may have been accretive or dilutive to your trends for the balance of 2017.

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Yes. Thanks, Brett. So the guide, if you look at the language on the revenue side, it's -- we said we'd be reasonably consistent on an organic basis. So as we think about that, we would remove out anything that wasn't in the business for all of 2016, 2017. So certainly, the impact of those businesses have been -- having about \$0.02 a quarter on EPS. So when I think about the guide going forward, it's on an organic basis. Still, feel very confident, organically, we'll be in a consistent place to where we were a year ago. And then we'll bake in the impact of the various acquisitions as we go forward.

**Brett Feldman** - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Does that imply that it's actually additive to your full year outlook? (inaudible)

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

As we get into each of those businesses, certainly, from a revenue standpoint, they are additive to the outlook. From an earnings standpoint, some of those businesses have an initial pressure as we integrate them, but not material to the earnings outlook.

**Brett Feldman** - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And then just a different question. If you think about unlimited and you were talking about doing more digital interactions and customer care, have you already started to see a benefit there? In other words, as your customer base has moved to unlimited plans, is that cohort contacting you less frequently? And could this be a real area of offset to some of the overage that you're losing on the top line?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Yes, absolutely. I mean, certainly, with customers on unlimited, they have fewer reasons to call and -- but we continue to want to improve the customer experience. And when customers can do the things by themselves through a digital channel at the time they want to do it, that increases overall satisfaction. And it certainly allows us to improve the efficiency of the business. So we're continuing to do that. And we think Unlimited, certainly, helps us do that as well.

**Operator**

Your next question comes from Craig Moffett of MoffettNathanson.



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**Craig Moffett** - *MoffettNathanson LLC - Co-Founder, Partner and Senior Research Analyst*

Matt, I wonder if we could return to the network densification conversation you had a few moments ago. Can you talk about how you think about the trade-off specifically between acquiring more spectrum and network densification and -- from an economics perspective? And has that shifted at all inside of Verizon? I mean, my sense is you're much different than a year or so ago. You're -- you spend less time talking about new spectrum acquisition. Is that a fair characterization?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

I don't -- look, we continue to look at that trade-off. It really comes down to taking a view on the most efficient way to add the capacity that we need. And we've talked for 2 or 3 years now about the fact that we believe based off of the valuations that spectrum have reached in some places, it's more efficient to densify. And certainly, the cost of densification, just like with any technology, have come down to some degree since we started densifying with small cells. So the overall analysis we do hasn't fundamentally changed. Look, we continue to add spectrum from the secondary markets, too. So when spectrum is priced at the right level, we continue to be active in that space, too. And we just look at the relative economics between densifying and adding spectrum. But densification has proved to be a very effective way of adding capacity in what places we need to and from a cost-efficiency standpoint as well.

**Craig Moffett** - *MoffettNathanson LLC - Co-Founder, Partner and Senior Research Analyst*

And if I could just ask a quick follow-up. I'm going to risk putting words in your mouth. But is it fair to say that you still believe, broadly speaking, that network advantage is still possible and within reach for Verizon with the network densification strategy?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Look, I think the results speak for themselves on this one, Craig. And whether it be the third-party results that you're seeing, again, just in the last 24 hours, but even in an unlimited world, the third-party results clearly show that Verizon has the best network. And then when you look at our subscriber metrics for the quarter, once we are on a comparable basis, we saw a record low churn down at 0.70%, sorry, and we also saw a strong net add number. So the idea that network differentiation doesn't matter to customers, quite frankly, the results from our base showed that, that's not true. And customers do value the benefit of a differentiated network experience, even when it's at the premium pricing, which is where ours is. We wouldn't get those results if a better network experience didn't matter to customers. Clearly, it does.

**Operator**

Your next question comes from Mike McCormack of Jefferies.

**Mike McCormack** - *Jefferies LLC, Research Division - Equity Analyst*

Matt, maybe just a little deeper on the churn that we saw in the quarter. Obviously, a very strong result there. Is it an impact from more EIP customers and sort of the equipment balances keeping people steady? Was there anything you guys were doing with respect to protecting the base with maybe proactively moving to unsubsidized without the EIP payments? And then just following up again on the guide on service revenue. What's the more important driver here for the year? Is it handset additions maintaining sort of a positive posture? Or is it the ARPA starting to turn? Or obviously, could it be a combination of both?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Yes. Thanks, Mike. So on the churn, look, there's no magic in here. It's not that we've got more customers on EIP or we've been doing things behind the scenes to protect the base. It's around the quality of the experience. And customers see that quality of the experience and they choose to --



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they want to be on that experience rather than something else. So we're very, very happy with the -- that number there. And it's just a reflection of what we give customers. And in terms of the guide on service revenue, I think the biggest piece that you have in there is the continued migration of the base to the nonsubsidized pricing plans in the back half of the year. The year-over-year comps are against higher numbers there versus the first half of the year, and that's going to drive the improvement in service revenue. Certainly, net account growth is an important contribution. But I think just the movement off the base and on an unsubsidized, that's the trend we've been talking about, and we certainly see that ahead of us.

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**Mike McCormack** - Jefferies LLC, Research Division - Equity Analyst

And, Matt, maybe just a quick follow-up on thoughts on towers. I know one of your biggest competitor, I guess, is looking for alternatives. Are you guys also evaluating some of those things?

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**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

We continue to look at all ways to manage the network at the most efficient pricing that we have, whether that be how we talk to towers or all the other resources we have in front of us.

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**Operator**

Your next question comes from Jennifer Fritzsche of Wells Fargo.

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**Jennifer Fritzsche** - Wells Fargo Securities, LLC, Research Division - MD and Senior Analyst

Matt, if I may, on the spectrum side, I know you've talked much about densification, but you didn't mention other spectrum sources. It looks like there's going to be a 3.5 gigahertz auction possibly next year. And it seems like Verizon has done most lobbying for that effort. In your spectrum kind of wish list, is it fair to say you're probably more focused on higher-band spectrum at this point? Or if you could comment on that. And then second, if I may, on the One Fiber initiative, it's certainly early to call 2018 CapEx, but do you still feel comfortable that with the fiber plans you've laid out or some which we know about, some we probably don't, that, that really won't be a huge increase in the CapEx level next year?

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**Matt Ellis** - Verizon Communications Inc. - CFO and EVP

Thanks, Jennifer. So on the spectrum wish list, look, we -- we're very confident in the portfolio of spectrum that we have certainly in low band and mid-band. And we have a significant amount of spectrum still to deploy against the LTE network. We'd certainly be interested in the 3.5 and look forward to that coming forward. But as I say, we're very confident in the spectrum that we still have to deploy. From a CapEx standpoint next year, look, it's too early to get into the guide next year. But as we think about how we deploy fiber and so on, that will be part of the plans. And we'll share those as we get towards the latter part of the year and certainly into January, when we provide the full year guide.

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**Operator**

Your next question comes from Simon Flannery of Morgan Stanley.

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**Simon Flannery** - Morgan Stanley, Research Division - MD

Matt, you talked a little bit about some of the pressures in the video business from over-the-top. How is Verizon thinking about that opportunity? Do you -- is there a case for you to have your own over-the-top product to compete? And how do you think -- I know on convergence, you've typically been conservative, but I think we're seeing a lot more of these converged wireless plus over-the-top offerings, and maybe just touching then on M&A and what your interest is and potentially owning more content to have some exclusive product for your customers?



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**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Thanks for the question, Simon. So on over-the-top, look, nothing to say there. We're always looking, but we'll see -- we'll continue to evaluate what we need to do to be competitive in that space and then the need to be part of the portfolio or not. From a convergence standpoint, again, we are -- we're very comfortable with the product offerings we have today. And if there is more convergence, we certainly believe that will take place on our networks. And we'll be effective as being part of that. And then from an M&A standpoint, look, we're very comfortable with the assets we have today. If there's an opportunity to add something or accelerate the strategy at a reasonable price, we will. But we think we have the assets we need to be effective at this point in time.

**Operator**

Your next question comes from Amir Rozwadowski of Barclays.

**Amir Rozwadowski** - *Barclays PLC, Research Division - Director and Senior Research Analyst*

I was wondering if we could touch upon sort of that network focus and the most efficient means to build additional capacity. When we think about your fiber footprint, you folks have certainly augmented it via acquisitions as well as some of the announcements that you've made to build out capacity. Where does it stand at this juncture in terms of the -- not just the fiber footprint itself, but having the right type of fiber assets to deploy 5G? And how do you expect to augment that capacity going forward?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Yes, thank you. So as we think about the fiber we need for the business, certainly, we need more going forward. As we've discussed in the past, the way that we're going to add that capacity will be probably through a combination of buying fiber that already exists if it's the right type of fiber. We can build fiber and we can certainly lease. And we were doing that on top of some of the assets we already own and adding the XO, those fiber metro rings earlier in the year, gives us the base on which we will continue to do some of that. So fiber will continue to be very important to how we build the network, not just for wireless, but also various wireline applications, including smart city deployments. So more to come there as we go forward.

**Amir Rozwadowski** - *Barclays PLC, Research Division - Director and Senior Research Analyst*

That's very helpful, Matt. And then just dovetailing on the prior commentary on over-the-top. Just want to try and put those comments that you had made in terms of evaluating options with some of the comments that seemed to have been made previously about you folks putting together an offering. I mean, has that changed in terms of timing or what your strategy is for over-the-top?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

I'd say there's no change to our strategy at this point in time.

**Operator**

Your last question comes from Tim Horan of Oppenheimer.



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**Timothy Horan** - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Matt, the Unlimited has had an incredible impact here. Do you think this is sustainable? Or are you seeing any slowdown at all? Maybe, I'm not sure if you said on the call what percentage your base around unlimited or maybe a flow share. And then I -- not to pound you on wireless margins, but it sounded like you're kind of expecting the trend up for the next several years, not just for this quarter. Do you think we can get back to, on a consolidated basis, the type of margins we saw last year or even better than that? And I guess, just lastly, how do you balance out the growth in subscribers with the margins that you're generating, which are still obviously industry-leading?

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Yes. Thanks, Tim. So we absolutely think the trend on unlimited is sustainable. Once we gave customers that clear and comparable offer, we see the value of our network and our offering compared to what else is in the marketplace. And look, we'll see how the marketplace evolves going forward, but we're very confident that we will be competitive as that happens. From a margin improvement standpoint, look, as service revenue trends improve, we'd expect that to flow through into margins. And then also we continue to have ways to take cost out of the business and improve efficiencies in the business, too. So you should think about that as you think about how we go forward in the wireless performance.

**Mike Stefanski** - *Verizon Communications Inc. - SVP of IR*

Okay. Great. And with that, I'd like to just turn the call back over to Matt on this busy earnings morning.

**Matt Ellis** - *Verizon Communications Inc. - CFO and EVP*

Thanks, Mike. I'd like to close the call with a few key points. We remain confident in our strategy of investing in our networks, while maintaining and expanding a high-quality customer base and developing new platforms and solutions. We are well positioned to compete in the current environment, while leading the industry in the 5G ecosystem with our strong network assets. We have the opportunity to do the things at scale, while delivering value across our portfolio in order to generate shareholder value. We look forward to the opportunities ahead of us and are confident in our ability to execute our strategy. Thank you for your time today.

## Operator

Ladies and gentlemen, this does conclude the conference call for today. Thank you for your participation and for using Verizon Conference Services. You may now disconnect.

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