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VZ.N - Q1 2023 Verizon Communications Inc Earnings Call

EVENT DATE/TIME: APRIL 25, 2023 / 12:30PM GMT

OVERVIEW:

Co. reported 1Q23 consolidated revenue of \$32.9b.

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PRESENTATION

Operator

Good morning, and welcome to the Verizon First Quarter 2023 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. Brady Connor, Senior Vice President, Investor Relations.

Brady Connor - Verizon Communications Inc. - SVP of IR

Thanks, Brad. Good morning, everyone, and welcome to our first quarter earnings conference call. I'm Brady Connor, and I'm joined by our Chairman and Chief Executive Officer, Hans Vestberg; as well as our current Chief Financial Officer, Matt Ellis, and Chief Financial Officer designate, Tony Skiadas. Before we begin, I would like to draw your attention to our safe harbor statement, which can be found on Slide 2 of the presentation.

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 posted on our website.

Earlier this morning, we posted to our Investor Relations website a detailed review of our first quarter results. Please note that during the first quarter, in order to better serve our customers, we reorganized the customer groups within our Business segment. We now report the following customer groups: Enterprise and Public Sector, Business Markets and Software as a Service and Wholesale. Prior period operating revenue results

within the business segment have been recast to reflect these changes. You will find additional details in the earnings materials on our Investor Relations website.

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

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thank you, Brady. Good morning, everyone, and welcome to our first quarter earnings call 2023. We delivered a solid first quarter marked by strong performance as we continue to execute on our plan to grow the business across mobility, broadband and private networks. We're making steady progress and expect to keep up the momentum going forward. We remain focused on delivering for our customers and driving service revenue, EBITDA and free cash flow. We grew total postpaid phone gross adds by 5% year-over-year this quarter and achieved 3% wireless service revenue growth, \$11.9 billion of adjusted EBITDA as well as a strong cash flow from operations of \$8.3 billion, an increase of \$1.5 billion versus the prior year.

We're working every day to move the business forward by using the power of America's most reliable network to deliver the best experience for our customers. During the quarter, we reached more than 200 million POPs covered by C-band in just over a year since we lit up the first site. With access to that spectrum and advancing the build-out as quickly as we did, we have enabled new source of revenue growth and elevated our customers' overall wireless experience.

In the first quarter, J.D. Power recognized us as the most awarded for network quality for the 30th time in a row. We're seeing improvements in already leading network performance validated by year-to-date RootMetrics testing and our customers are taking notice. Where we offer C-band, we see significant benefits in fixed wireless access, consumer phone gross adds and retention as well as premium take rates. We also see 4G customers benefiting as we offload traffic in some markets to our 5G Ultra Wideband network. The performance improvements will continue as 5G penetration expands market by market.

We're excited about the remaining deployment of C-band spectrum and the potential it will unlock for both our business and consumer performance. Moving on to mobility. On the business side, even in the current economic conditions, my peers across different industries have conveyed confidence that mobility remains a priority in their spending. During the first quarter, Verizon business continued its run of strong performance, delivering 136,000 postpaid phone net adds. This was accomplished in spite of some pressures around restructurings within the technology sector.

On the consumer side, payment trends are at healthy pre-COVID levels and consumers are shopping, evidenced by our increase in consumer postpaid phone gross adds, which were up 11% year-over-year, with the new to Verizon adds leading the way. Our gross add performance is proof that our surgical and segmented approach to the market is working. We're in a much better position than a year ago, entering the second quarter with a sustained momentum around gross adds as well as postpaid churn where we saw improved performance each month across the first quarter.

We remain committed to our strategy, not to compete on who can discount the most, but rather who can offer the most value to customers, the best overall experience and the best customer satisfaction. +play is a great example of this. We listened to our consumers and introduced exciting partners like Peloton and Netflix providing exclusive deals on an easy-to-use subscription managed platform, and there is more to come. Our segmented approach to the market recognizes that one plan doesn't fit all, and we have continued the work to address our underperforming segments. I've talked about our efforts to be more targeted and surgical with our retention. And we saw that play out during the quarter.

By reducing upgrade volumes and lowering inefficient spending, we were able to deliver working capital benefits while finishing the quarter in a good place with churn and executing on migrations to premium unlimited. Those are real cash savings and a key driver to the large year-over-year improvements in free cash flow. You have seen us taking pricing action most recently on some of our legacy unlimited plans. We continue to look across our base and evaluate opportunities to more closely align pricing to our value proposition. On prepaid, we are working diligently to realize the full potential of this segment. While net adds were down by more than [270,000](corrected by company after the call) versus the prior year, this total was affected by 2 transitory factors.

First, more than 100% of our net year-over-year decline came from higher disconnects within our SafeLink brand, which provides services to customers on government subsidized programs. We're still in process of migrating customers onto our network as well. Prepaid is an important part of our value segment strategy and our investments here will continue as we're confident they will pay off in the long term.

Turning to broadband, which is a major growth area for us across consumer and business. We achieved the highest net adds in over 10 years, adding 437,000 total net adds within the quarter, including 67,000 net adds from Fios. We are very pleased with the Fios performance with net adds up 12% year-over-year. For fixed wireless access, we're seeing growth quarter after quarter after quarter with 1.9 million subscribers at the end of the first quarter, fixed wireless continues to scale and contribute increasingly to our revenue performance.

Our business customers are increasingly turning to fixed wireless access as their primary source of broadband connectivity. Won over by the reliability and the overall value of the product. In addition to taking share from our competitors, we're also seeing new use cases across all of our customer groups leveraging the flexibility of the product to expand beyond what traditional wired broadband can do.

Finally, in private networks, our Verizon business team continues to execute at a high level. We announced new deals with KPMG and Deloitte and have a strong funnel of business ahead of us. We have also established a leadership position as a top network provider in the public sector. This quarter, we announced a 15-year critical infrastructure contract with the FAA worth over \$2 billion to design, build and operate and maintain the FAA's next-generation communication platform. This is in addition to many ongoing projects we're working on for large federal agencies.

In creating the networks that move the world forward, we remain committed to running our business responsibly for our customers, shareholders, employees and society. Last month, we published our 2022 ESG report, which highlights how business ethics, governance, environmental stewardship and human rights are at the center of everything we do.

I encourage you to take some time to review the report and learn about how we are managing risk and unlocking opportunities surrounding the issues of utmost importance for our stakeholders. Our commitments here come right from our leaders and their teams. A few weeks ago, I announced new leadership for our 2 business units, the network organization and our Chief Financial Officer. These leaders come with nearly 100 years of experiences within Verizon and bring a proven track record of successful execution.

Let me take a moment to walk through these changes. Sampath takes over as a CEO of Verizon Consumer. His objectives are clear: to enhance our consumer operation model and experience, deepen our segmentation approach, scale fixed wireless access and broadband and drive financial discipline. Kyle Malady was appointed CEO of Verizon Business. CIOs are increasingly searching for technology reach solutions, and nobody knows our technology like Kyle.

His focus is clear: drive sustainable growth in mobility and deliver on the revenue growth opportunities within fixed wireless, 5G private wireless and mobile edge compute solutions. Joe Russo takes over as President of Global Networks and Technology to continue our efforts to extend, enhance and solidify the nation's leading wireless network and vast global IP and fiber network. Finally, Matt Ellis leaves us at the end of the month, after 10 years at Verizon and 6 years as our CFO. I want to thank him for his many contributions to our business.

Tony Skiadas assumed the title of Chief Financial Officer on May 1. I appreciate Tony's work to improve operations and drive performance as we search for a long-term CFO replacement. So let's now move on, in talking about efficiencies. The teams are on the way to deliver better, simpler and more efficient end-to-end processes for our customers and employees. Spearheaded by the Verizon Global Services Group, we're looking into numerous areas across the business that will help drive bottom line growth, including IT platform transformations, building advanced AI models for the better diagnostic and predictive insights, optimizing our real estate footprint and managing our supply chain efficiently.

We have also reduced headcount over the last quarters. All in all, our cost efficiency program is on track to achieve our target of \$2 billion to \$3 billion of annual savings by 2025, which will help to fund our growth as well as drive margin improvements over time. With almost all our \$10 billion C-band capital expenditure program behind us, we expect our cash generation profile to expand over the next few years, driven by revenue growth, cost management and efficiencies with capital expenditures. This helps support our objective to achieve consistent dividend growth with our 16 consecutive years of increases currently the longest streak in the industry.

As we look to build on the free cash flow growth generated in the first quarter, we expect to see significant improvement in our dividend payout ratio this year putting the board in a strong position to increase the dividend once again and bring us closer to our debt targets over the following years. Going into the second quarter, I'm energized by the execution of the Verizon team and our new leadership across key positions. We remain focused on delivering for our customers and driving service revenue, EBITDA and free cash flow expansion.

And with that, I will now turn it over to Matt for the last time.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Thank you, Hans, and good morning. Our results for the first quarter reflect the steps we have taken to improve our performance. C-band and the investments in our network are having a positive benefit on customer and overall network experiences. And as Hans mentioned, we are seeing a direct benefit around fixed wireless and phone gross adds, among other metrics, where we operate C-band, but more work remains to be done. Taking a look at operating results of the first quarter, let's start with consumer postpaid phones, which had 263,000 net losses for the quarter compared to 292,000 net losses for the prior year period. Consumer postpaid phone gross adds was strong across the quarter, up over 11% year-over-year, continuing the momentum from the second half of last year.

Our efforts around the segmentation of our base and our more targeted go-to-market approach and offerings to those different customer groups have been key drivers behind our improved gross adds performance. Consumer postpaid phone churn for the quarter was 0.84% and up 7 basis points compared to the same period last year. We are now seeing a return of involuntary churn rates to pre-pandemic levels. As for voluntary churn, performance was mixed across the quarter starting off elevated as we saw normal holiday season activity extend into the early parts of the first quarter.

But as the quarter progressed, we saw improvements in terms of year-over-year churn performance, exiting in the quarter with voluntary churn rates in line with last year. While we have more work to do to improve consumer net adds, we are encouraged by the double-digit percentage improvement in gross adds combined with the improved churn level at the end of the first quarter. We entered the second quarter with significantly better momentum than a year ago.

Moving on to the business segment. Verizon Business again delivered strong results. We saw solid demand across our 3 customer groups and had 136,000 phone net adds for the first quarter compared to 256,000 for the same period last year. The year-over-year change was primarily due to a couple of large deals that contributed to our net adds results a year ago. Additionally, we saw an increase in churn due to business customers being more cautious around spending and the restructurings Hans noted in his remarks.

Moving along to broadband on a consolidated basis, we delivered 437,000 net additions in the first quarter, the most in a decade. As expected, we saw another quarter of sequential growth in fixed wireless with 393,000 net adds, up from 379,000 in the prior quarter. Customer satisfaction remains high as evidenced by NPS scores as well as encouraging churn trends around the more tenured cohorts of customers. On the Fios side, Internet net adds for the first quarter was 67,000 and up from 60,000 in the first quarter of last year.

Customers continue to be attracted to our high-quality broadband products, which is reflected in the year-over-year increase in Fios gross adds even in an environment with lower move volumes versus the prior year.

Fios retention rates continue to be strong with our best churn performance in more than 5 years. While the first quarter results were prepaid were below our expectations, we remain confident in the value market opportunities and the benefits of having a portfolio of assets and plans that satisfy the needs of all of our customers.

You heard from Hans some of the actions we are taking to create long-term value. As expected, in the short term, these actions are having a negative impact on our prepaid net adds. Together with the elevated disconnects and our SafeLink brand that Hans referenced, we expect pressure on prepaid net adds to increase in the second quarter before they abate later in the year.

Moving on to the financials. Consolidated revenue for the quarter was \$32.9 billion, down 1.9% year-over-year primarily due to equipment revenue being lower by 9% as well as continued declines in business wireline services. Wireless service revenue was \$18.9 billion, up 3.0% year-over-year.

As we discussed on our fourth quarter earnings call, results for the first quarter included a benefit of approximately 185 basis points associated with the large allocation of our administrative and telco recovery fees from other revenue into wireless service revenue. This benefit was partially offset by the impact associated with the shutdown of our 3G network completed at the end of the fourth quarter. The shutdown resulted in the removal of approximately 1.1 million retail connections and the corresponding loss of revenue for the first quarter and beyond.

We continue to see pressure on service revenue from the costs of promotions and the amortization impact in the first quarter. Additionally, we see pressure from prepaid revenue as a result of lower subscribers versus prior year. To help offset these pressures, we've recently implemented additional pricing actions across our business and consumer segments. We expect to see the benefits of these actions ramp across the second quarter as the business segment began billing customers closer to the end of the first quarter, while consumers started earlier this month.

As a result of these combined pricing actions, we anticipate approximately \$75 million of incremental quarterly revenue moving forward. Additionally, the consumer team is working to improve efficiencies around device promotions and credits that we expect to yield revenue benefits across the remainder of the year. We believe that the actions the teams are taking will grow the top line, driving both EBITDA and cash flow. To complement this, the team expects to make additional progress across 2023 on the development and implementation of cost efficiency initiatives, resulting in a meaningful savings run rate at the end of the year.

During the first quarter, operating expenses, excluding depreciation and amortization, were down 2.4% year-over-year, primarily due to lower cost of equipment from reduced upgrade volume which helped to offset an increase in bad debt of approximately \$200 million. Similar to involuntary churn rates, bad debt expense reflects the return of collections to pre-pandemic levels. While up year-over-year, bad debt expense is relatively consistent with the prior quarter.

Cash flow from operating activities for the first quarter totaled \$8.3 billion compared to \$6.8 billion in the prior year. This increase was primarily due to working capital improvements driven by lower inventory levels, coupled with fewer upgrades and a modest improvement in customer payment patterns despite the current macroeconomic conditions. CapEx for the quarter came in at \$6.0 billion, which includes most of the remaining \$1.75 billion of C-band-related spending in our guidance.

With the conclusion of the program, we would expect a step down in the pacing of overall CapEx throughout the remainder of the year and continue to expect 2023 capital spending to be within our guidance of \$18.25 billion to \$19.25 billion. The net result of cash flow from operations and capital spending is free cash flow for the quarter of \$2.3 billion up \$1.3 billion versus last year. Total unsecured debt for the quarter was \$132.0 billion, an increase of \$1.4 billion compared to the end of 2022 and \$5.3 billion lower year-over-year. This resulted in net unsecured debt to adjusted EBITDA ratio of 2.7x as of the end of the first quarter. A 0.1x improvement compared to the first quarter of 2022 and flat from the prior quarter.

We continue to have very low near-term unsecured debt maturities with the only maturity remaining in 2023 being approximately \$600 million due in the second quarter. I wanted to take a moment to acknowledge that this will be my last earnings call as Verizon's CFO. It has been a fulfilling 10 years at Verizon and a privilege to serve as CFO, and I'm thankful to everyone that has made it such a rewarding experience.

From our talented finance team to my fellow executive team members to all of you that have had the pleasure of getting to know I want to say thank you. Verizon is in good hands with Tony as its CFO. I've worked closely with him since my first day at the company, and I know he will always strive to drive the business forward in a way that puts Verizon and its shareholders first. I truly look forward to seeing what he and the entire Verizon team will achieve as I cheer them on from the sidelines as an enthusiastic customer and shareholder.

With that, I will now turn the call back to Hans for concluding comments before we open up to your questions.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thanks, Matt. In summary, our disciplined approach has led to significant progress on our key strategic plans and we need to keep the momentum and focus going. We're pleased with how 2023 has started. We continue to deliver the best customer experience on the most reliable network supported by the best people in the industry. In mobility, our segmented and surgical approach to the market is working, and we are taking pricing actions where possible.

In broadband, the combination of fixed wireless access and fiber is winning as we continue to capture market share. We'll continue to grow our cash generation profile and maximize shareholder returns aided by our cost efficiency program and lowered capital expenditures. I remain confident in our strategy and our strong focus on execution. We are always identifying new ways to evolve our business and execute on opportunities. In everything we do, we focus on driving profitable growth. We measure our success in maximizing value across stakeholders for our ability to grow service revenue, EBITDA and cash flow.

Brady, over for the questions.

QUESTIONS AND ANSWERS

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Thanks, Hans. Brad, we're ready to take questions this morning.

Operator

(Operator Instructions) The first question for today comes from John Hodulik of UBS.

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

Great. And Matt, thanks for all the help over the years and best of luck to you in the future. If I could just start with a couple of wireless questions. First on the gross adds on the consumer side, obviously, some strength there. Any other detail you can give us in terms of what's driving the double-digit improvement. I think AT&T saw a decline.

If there's just any change in the sort of promotional posture or anything you're doing there? And then on the other side of the ledger, churn, obviously up a little bit year-over-year, but it sounds like you're making some trends. Did you guys make any pricing changes on the consumer side in the first quarter? And just -- any comments around the sustainability of those improvements as we look forward throughout the year?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thank you. Let me start, and then I'll hand it over to Matt. I think what we saw in the first quarter was very much the momentum. We start building I would say, end of the third and into the fourth when it comes to both how we converted our customers to be part of our journey with the more segmented approach. And that we have seen through the quarter when it comes to our gross adds that many of the initiatives we have had all the way from the welcome plan and many of the others, they have been working well for us. So that's partly what we have been doing.

And then, of course, I think we're much more focused. And of course, now with the new team in place as well, where we have full alignment with Sampath when it comes to the execution here and seeing that we're getting the right customers in. I think that has been helpful as well. Then as you have seen, we're coming in and out of the quarter with promotions. We really are taking the opportunity when we see that we have an opportunity to bring in customers. So that's how are you seeing the momentum continue. And as Matt said also in his opening here, we have seen that momentum continuing for us.

And for the churn, I will hand it over to Matt. But as I said, I mean, we had a little bit higher in the beginning of the quarter and it continued to improve. And we are working with both that as well as we continue to create the momentum we have right now on the consumer wireless. Matt?

Matt Ellis - Verizon Communications Inc. - Executive VP & CFO

Thanks, Hans. So on the churn side, certainly, we saw improvement as the quarter went on. We had a little carryover from holiday level churn in January by the time we got to March, we saw a much better momentum there. So that's the jump-off point as we go into second quarter. The pricing changes that you mentioned in your question really didn't go into effect until we kind of came to the moving from Q1 to Q2 so that will be incremental to the results of the business here as we get into the rest of the year.

So -- but as Hans said, really a case of rebuilding from the momentum last year that was a year ago was not where we wanted it to be. At the midpoint of the year, we talked about taking actions, and you see the results of those actions showing up in the results. And so the team is focused on continuing to build from there.

Operator

The next question comes from Brett Feldman of Goldman Sachs.

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

I'd also like to reiterate my thanks to Matt for all his help over the years. My question is about fixed wireless. So when I look at the formal remarks document you put out, it looks like you still have just over 40 million households where that can get your fixed wireless service. The reason I bring it up is that would appear to be a fraction of the availability of your ultra-wideband network, which now covers over 2/3 of the population.

So I was wondering, how do we think about the game plan for expanding the distribution of the fixed wireless service now that you have significantly expanded the ultra-broadband -- ultra-wideband network? And how do we think about the cadence of quarterly fixed wireless access here? Is there still going to be a tailwind? Or are we getting to a point where it's leveling now?

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

Thank you, Brett. First of all, we're really pleased with the performance on the fixed wireless access. The team is doing a great work. And remember, it's not only the consumer side, it's the business side as well on the business side. Many new use cases are coming up on using fixed wireless access. So the team are scaling, and we're on scale right now. So like the rhythm I see on our sales promotions right now. And if you see in the first quarter, almost 400,000.

When it comes to the network, you know that later -- the latter part of this year in December, actually -- or we will get our next chunk of C-band. Right now, we're covering some 70 markets out of all 400. So it's 330 markets left, we will get the C-band. And we clearly pointed out in the opening here that where we opened the C-band. We're not only seeing fixed-wire access opportunity. We also see step-ups and a greater upgrade cycle for our customers because they see the improvements on the C-band. So we're very encouraged by the C-band coming out. But as I said, we're waiting for the clearance by the year-end to get even more. But as we roll out right now, we open up markets.

And remember, we talked about that we are in the network team, we're now decentralizing so we can attack locally because we are sort of opening markets locally. The same goes what Sampath is working on right now is also taking his operations more locally, so we can both the marketing and execution locally. And you might have seen it that we do more local things because as we open up more on fixed wireless access. We do that locally. And so far, our success rate is high. We're just going to go do this in the right way to take the learnings with us doing better all the time.

We also have started with differentiation on different type of peers when it comes to our fixed wireless offerings. There's a lot more to be done there.

But as I said, I'm very pleased with the rhythm and the market share we're taking and remember, the C-band, so far is deployed mainly in urban and suburban areas, the majority of the spectrum coming is actually in more of the suburban and rural. And we also get, of course, more urban spectrum as we're only deploying 60, maybe 80-somewhat megahertz, 100 where we are, in average, 160. So I have to say this is one of the biggest 5G use cases we have right now, and we really seeing good traction. So that's how we're going forward.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Yes. Thanks, Brett.

Operator

The next question comes from Simon Flannery of Morgan Stanley.

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

Again, my best wishes to Matt for the future. Just following up on Brett's fixed wireless question. You talked about scaling. It looks like you're almost hitting 2 million fixed wireless subscribers now. How is it working on the network capacity side of things? And what's your confidence in going to continue to handle increasing usage from the customers as this continues to scale?

And then if we could just go back to the announcement, I think it was March 3 of the new appointments. You talked a little bit about Kyle and Sampath. But what if we were inside Verizon, what are the big changes that have taken place over the past 7 weeks or so that are really changing the trajectory, particularly of consumer.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thank you, Simon. On the capacity, we -- the guys is great. First of all, were used on an initial trends of spectrum that we're using, as I said, we were fixed wireless access on the ultra-wideband. We have so much more capacity coming. On top of that, all the new features you have with advanced 5G carrier aggregation, we have new devices coming out that can handle different spectrum.

So there are so many more things I feel really confident that we will manage this capacity without any problems to the levels we have talked about and way beyond that. Then, of course, as I talked with many of you guys, if it comes a moment that we have a community that have a lot of fixed wireless access we will have over time, other opportunities of cell splitting, et cetera. We are not even close to that today.

So I feel really good about how the guys are managing the network and the opportunities we're building on our C-band here. As I said, on the 4G fixed wireless access, they were more opportunistic and selling when we see that we have capacity, but not sort of where we see that we have that full. We're not selling any more. But this expansion is right now on 5G Ultra Wideband.

When it comes to the new team, the big changes I've seen, first of all, the first big change is that these guys are operational day one. I mean both Kyle and Sampath is straight into it. If you look at Sampath, he's very much focused both on the customer dimension and seeing that we were improving the momentum we have right now on gross adds and churn and see that we actually improving through the year. But he also works with our offerings and our operations, see that we're even stronger locally. Kyle, on the other hand, continuing the work of Sampath, great momentum on Business Wireless as we continue this quarter private networks is really taking off.

And then on top of that, working with a wireline decline to see that we're taking out cost at the same time, managing our contracts and I don't think there's no one better than Kyle. He knows the network that more than anybody else. So I think that's the main focus and they've been really fast. And then, of course, the transitions between Tony and Matt is going extremely simple because these guys have worked together for 10 years. Tony is already into all the operations, working very closely with the new leaders all the way from Joe, that's running networking Kyle and Sampath. So I feel good. I feel really good and confident about it, and it's very clear that the priorities there. So maybe, Tony, you can say something about your priorities.

Tony Skiadas - Verizon Communications Inc. - Chief Financial Officer Designate

Sure. Thanks, Hans and good morning, Simon. I'm excited to have the opportunity to succeed Matt as the CFO. In terms of my priorities, I have 3 of them. First, supporting our new leaders, Sampath, Kyle and Joe in executing their strategies. And that includes narrowing our focus with a very strong emphasis on operational performance; second, ensuring that we deliver the 2023 financial guidance that we laid out in January and third, ensuring that we continue to execute on our capital allocation strategy, the 4 capital allocation priorities that we shared with you last year, those remain unchanged. So those are my 3 priorities right out of the gate. And as Hans mentioned, the transition has gone exceptionally well.

Simon Flannery - Morgan Stanley, Research Division - MD

Great.

Brady Connor - Verizon Communications Inc. - SVP of IR

Thanks, Simon.

Operator

The next question is from Phil Cusick of JPMorgan.

Philip Cusick - JPMorgan Chase & Co, Research Division - MD and Senior Analyst

Two, if I can. First, can you expand on the bad debt and churn discussion and how that relates to the upgrades, which seem to be fading through the quarter? And then second, if you can talk about prepaid. Are the losses mostly happening in SafeLink and what is happening in this and the different brands and any conversion of prepaid to postpaid this quarter? And how would you report that if it was happening?

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

Okay. That was a lot of questions in one. I will start on the high level here on the -- as we said earlier, the payment patterns are basically same as pre-COVID. We have a high-quality customer base. We see this as a very healthy at the moment, all the way. I will ask Matt to expand on that because looking backwards. And then when it comes to the question on prepaid, or value segment, yes, as we said in an opening here, I mean, the negative number is, I would say, 100% coming from SafeLink, which is a government-subsidized brand.

But there are other puts and takes there as well. I think that the visible brand is doing well. We're just ramping up total wireless, which is an important piece of it, not having all the things coming through there. So -- and then, of course, we have the network migration still happening. So it's combination of a lot of things on the different brands. Our confidence is that we will improve that at the latter part of the year when some of these things are moving out. So that's a general comment, maybe on the churn piece, Matt, if you say something.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes. Thanks, Phil. So looking at the churn and the bad debt and to your question was more around the bad debt side. So certainly up a little bit year-over-year, but more importantly, flat sequentially. And what you're really seeing is first quarter last year, we still had some impacts in there of some of the COVID-related activities. That's now fully out.

And I'd say we're back to perpetual type run rate. In terms of the -- with the lower upgrades in there, also the plus 11% phone gross adds, as Hans mentioned in his prepared remarks, a lot of those gross adds were new to Verizon. And those new to Verizon customers typically come in at a different bad debt accrual rate than upgrades, which is existing customers that we know well and so that's the trade-off there.

The other thing I look at on the bad debt side. One, you see from our most recent ABS filings at our FICO scores across our base continues to be very strong. We've talked for many years now about the quality of the Verizon postpaid base and you see that there. And then secondly, the payment patterns we actually had from customers this quarter actually just slightly better sequentially in terms of the aging. So we're seeing good behavior, good payment activity from our customer base, which is why you see the flat bad debt on a sequential basis now that we're fully through the COVID period.

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

If I can just follow up, was there any conversion from prepaid to postpaid? Or I may have missed it.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

A little bit, but nothing material, but that's obviously certainly something the team is very focused on going forward, having that opportunity in there, got that's still ahead of them to be a much more meaningful contributor going forward.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Yes. Thanks, Phil.

Operator

The next question comes from David Barden of Bank of America.

David Barden - *BofA Securities, Research Division - MD*

Thanks for all the help, Matt. I guess in the prepared remarks, Matt, I think you mentioned that there were going to be some cost efficiency benefits in 2023. I was wondering if you could kind of -- in that \$2 billion to \$3 billion target, talk about the cadence of how you see that unfolding in maybe the second half of this year and into the coming years?

And then the second question would be one of the things that's contributed to, I think, the momentum that you guys have been talking about a lot on the call has been a combination of the new kind of more affordable welcome unlimited plan and a lot of the marketing you've been doing. Could you talk about what the new kind of management team wants to do to take that maybe to another level, if at all, this year and kind of what the end goal is flat subscribers the goal? Or is market share the goal? That would be helpful.

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

I will start, and then I will toss the question and toss to Tony, and I will start with your second question. So the team -- I think we just need to divide the wireless question that you have. On the business side, I think it's clear, we're really strong. We are taking market share. The team is working through SMB, government and large enterprises with our offerings where the network is the key contributor.

Kyle will continue that work and the drumbeat we have there. On the consumer side, I think that Sampath and I are 100% aligned that we are in a momentum where we are now going to continue to improve our net additions on consumer, but most importantly is to grow in the service revenue but of course, we want customers as well. But mostly important is growing the service revenue and expanding the cash flow and EBITDA. That's really the main focus for Sampath that were 100% aligned on. But that also means that we need to take customers. And I think that we will continue to evolve our proposition and coming with new products.

So I feel encouraged what I've seen so far and the thinking that Sampath and the team have, but we need to stay tuned for some of the new things coming, Tony?

Tony Skiadas - Verizon Communications Inc. - Chief Financial Officer Designate

Thanks, Hans. David. So on the cost side, as we mentioned in the prepared remarks, we're making progress with Verizon Global Services and all the cost transformation efforts. As we mentioned previously, we're on track with our cost efficiency program to take \$2 billion to \$3 billion of cost out by 2025. Within that, we'll see some of those benefits manifest themselves in the second half of this year in '23 with significant savings in 2024 and really focused on areas like sourcing, transformation, IT conversions and transformations as well as supply chain and other AI models.

Brady Connor - Verizon Communications Inc. - SVP of IR

Yes. Thanks, Dave.

Operator

The next question comes from Michael Rollins of Citi.

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

Matt, I also want to express my thanks and best wishes as you leave Verizon. If I could focus on 2 topics. First, on the ARPU side, if you can unpack a little bit more in terms of what you're seeing on the unlimited and premium unlimited take rates and where those can go over time in terms of continuing to monetize the network and the bundles that you offer? And then on the lower upgrade rate, are you seeing a fundamental change in customer holding periods for devices and what does that mean for the size of the switcher pool in the industry going forward?

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

I can start. I mean, we -- I can on a high level, say we continue to see the trends from our customer on postpaid going to unlimited and then go to unlimited premium. That continues, the team is doing great work to see that we're doing that transition. And -- but we still have opportunities. We still have customer metered plans. We still have a portion on unlimited, it can go to unlimited premium.

So we still see that as an important growth trajectory for our ARPU going forward. And then on the upgrades, I mean, we have talked about before, I mean the market indication is that it's going to be a little bit smaller switcher pool. That doesn't mean that we feel that we shouldn't be taking more fair share. We should definitely do that and continue to see that our customers that we have, we're expanding with them, and then we're

actually bringing new customers. So I think -- that's what we see right now. But again, we have good momentum with all the offerings we have. I expect my consumer team come out with new offerings as well. So -- and continue that drumbeat, Matt?

Matt Ellis - Verizon Communications Inc. - Executive VP & CFO

Yes. No, exactly, Hans. And Mike, so as you think about it, the strategy is 1 always to get the customer in, then have the opportunity to move customers up the stack and you see we've done that number of different ways over the years, and you should expect us to continue to find ways to do that.

And then also, we get the opportunity to add other things to the account, so fixed wireless access allows us to increase ARPA and adding other devices to the accounts, too. So there's still significant opportunities there for us to grow share of wallet with the customer as we go forward. And I would expect that the consumer team will continue to make sure that they are having the right pricing constructs and offerings in front of customers, and those will constantly evolve over time so that we can continue to grow ARPA.

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

And if I could just throw one other out there. Just from a government program perspective, can you share how Verizon participates in ACP? And any new thoughts on potentially participating in the BEAD program?

Matt Ellis - Verizon Communications Inc. - Executive VP & CFO

Yes. So I'll take the first shot. Look, ACP is an important program. As you've seen, the actions we've taken over the past few years, whether it's the acquisition of Tracfone, the introduction of plans like Welcome. We want to participate in all customer segments. That includes ACP, whether that be on the wireless side or the fixed side. So we do participate in those programs. And then as the BEAD programs come out, we will look for where it makes the most sense for us to participate in those programs. We've been doing -- we've been building fiber out to our homes for a long time. We continue to do so.

Over 500,000 new OFS last year, we said we'd do something in that same region again this year and into the foreseeable future at that type of run rate. So as that those new programs help us the opportunities to continue to do that will certainly be very interested in looking at using them where it makes sense.

Brady Connor - Verizon Communications Inc. - SVP of IR

Yes. Great. Thanks, Mike.

Operator

The next question comes from Craig Moffett of MoffettNathanson.

Craig Moffett - MoffettNathanson LLC - Co-Founder, Founding Partner & Senior Research Analyst

I want to sort of step back to a more strategic question about the wireless business, if I could. I mean for years, your business model and your -- and sort of the way you came to market was based on a very low churn strategy, therefore, arguably, you didn't need the same number of gross adds to sustain growth. And it was based on a very clear value proposition of Best Network.

It seems like all of those pieces are quite different now. And despite what you said about the prospects for churn, churn is quite a bit higher for retention. How do you kind of win the battle for the hearts and minds, particularly in the consumer segment by sort of returning to the base of convincing customers that yours is really the best network and sort of how do you win with the value proposition?

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

I will start here. First of all, what we see right now is we have a clear value proposition when we roll out the C-band. We have great uptake, step-ups from our customers when they see the C-band. And you know better than anybody else how much of that spectrum we have right now, which is a very little bit. And with all that, we get this momentum, that's why I feel so good about it.

And then as Matt said, our churn a little bit elevated, but it's also improving in the quarter. So we're working on that. And having a gross -- the gross adds momentum at the same time. That tells you something about where we're going right now heading. And then we have Sampath in the role that really no operational execution. So I think we have all that and we have the best network clearly, and it's just going to get better. I mean with every measurement we do right now, we are clearly come out as #1.

And the only thing I know for sure. We're going to extend that leadership with the C-band continue to roll out. So our proposition is very clear, continue to have the best network, have a good proposition for our customer because you need to continue to do new offerings to the consumer group because their behaviors are changing as well. That's why we came with it, +play. We're listening to customers to make it easier and all of that. And you haven't seen the loss from us. So I think that we're building on all the strength we have and those strengths are even getting stronger.

Brady Connor - Verizon Communications Inc. - SVP of IR

Thanks, Craig.

Operator

The next question comes from Tim Horan of Oppenheimer.

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

Can you be a little clearer on the network upgrades -- it looks like you're more than doubling the amount of spectrum by year-end. What does that mean for coverage, do you think, and capacity? And when will we get to 300 million homes passed and more like 70 million or 80 million that have the ability to get fixed wireless?

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

So on the network, you're absolutely right. We have just -- on the C-band we have just started to roll it out in the majority of the 60, 70 markets we're rolling out right now, we're using 60 megahertz. And you know we have an average 160 megahertz and in many places, even up to 200 megahertz. So it's an enormous difference when it comes from 60 to 160 megahertz, how much more capacity there is and on top of that, of course, we are adding new type of software features like carrier aggregation, the chip sets is getting better in devices, both the handset and the fixed wireless access devices.

So that's going to enhance the capacity for us. And as I said, we were very focused to see that we materialize our business cases for the C-band, all the way from consumer and business wireless to fixed wire access and mobile edge compute and private networks. So we focus on the revenue generation of it, and we'll continue to do so. But clearly, it's going to be a step-up when we get the next tranche. And we're going to open more homes or households penetrated with fixed wireless access, and we're going to have much more markets covered by the C-band. So we're just going to continue that journey as fast as we can.

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

But does the increase section help the coverage? Or do you still have to build out in those areas?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

I would say, as we said from the beginning, which many people doubted we can use our existing 4G grid for the C-band. There is -- we don't need any new. However, we always build some new sites. We find new areas where there have been capacity constraints.

We'll continue to do that as well. But mainly our C-band is using the 4G grid in order to see that the coverage is coming out there. And this year, we're going to build a little bit more sites than we've normally done and the -- and our 4G spectrum AWS and et cetera, is covering 300 million POPs a day. And that's where we'll build our C-band right now.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Yes. Great, Tim.

Operator

The next question comes from Kannan Venkateshwar of Barclays.

Kannan Venkateshwar - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

Thank you. Hans, strategically, you face a few choices, which I think are contradictory in some way, and there is an attempt to grow gross adds, obviously, but SG&A is growing faster than revenues, and so that puts pressure on margins. And it also comes with cash flow trade-offs. And you are trying to increase price to offset this margin impact, but that comes with churn trade-offs.

So ultimately, when you think about your growth model or the growth algorithms what's the north star? Is it unit growth? And are you willing to sacrifice margins and cash flow to get to that turnaround point? Or is it margins? Even if it comes at the expense of unit growth because it does feel like there is a choice that has to be made at some point. And I'm just wondering what the metric is that you're most focused on?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

I think it's crystal clear. Our metrics that we're measured on is the service revenue and the EBITDA and cash flow expansion. You still need to have customers for that, and you need to grow that. But ultimately, that's what we measure ourselves on to see that we can grow that. And that's what you have seen from us right now. And you see the cash flow in the quarter. We are very focused on that. We think that's very important for all the stakeholders. And so then, of course, units are important, but it's even more important to see that we have the right growth metrics when it comes to the company's finance. But maybe Tony wants to add something here.

Tony Skiadas - *Verizon Communications Inc. - Chief Financial Officer Designate*

To just add on to what Hans mentioned. I mean we have to be disciplined and segmented in how we approach the market. Our focus is on volumes that drive profitable revenue growth. So the team is laser focused on that.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Good. Thanks, Kannan.

Operator

The next question is from Peter Supino of Wolfe Research.

Peter Supino - *Wolfe Research, LLC - MD & Senior Analyst*

Question back to fixed wireless. Obviously, the expansion to suburban and rural markets is a big opportunity back in the urban areas where your C-band depth is going to more than double in 2023. Is there any reason that expansion shouldn't support accelerated marketing and approval of inbounds about FWA so that you would drive up your net adds in those markets as well?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

That's clear. I mean, and that's why our organization, both on the consumer side and the business side and our network side, it's more regional right now because we're following the sort of the deployment of the network and doing marketing and outreach to our customers on fixed wireless access that really want to have it when we open up. So clearly, you're right, there is also opportunity in the urban places where we get more capacity or more coverage and as it goes for the suburban and the rural.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Great. Thanks, Peter. Brad, we have time for one more question.

Operator

Your last question will come from Frank Louthan of Raymond James.

Frank Louthan - *Raymond James & Associates, Inc., Research Division - MD of Equity Research*

Can you -- with the business changes, can you walk us through on the SaaS line? What is sort of SaaS revenue in total and where can you see growth there? And then back to the phone adds with the new level of gross adds you're getting, are there any characteristics about this type of customer you're tracking now that might be different than, say, 2 years ago and what their long-term churn characteristics might be?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

So you need to repeat the first question. You're talking about SaaS revenues?

Frank Louthan - *Raymond James & Associates, Inc., Research Division - MD of Equity Research*

Well, with the breakout -- new breakout on the business line item. Just curious how much of that line that includes SaaS. Is SaaS revenue and what is that growing?

Tony Skiadas - Verizon Communications Inc. - Chief Financial Officer Designate

Yes. We don't disclose the SaaS revenue specifically, so.

Matt Ellis - Verizon Communications Inc. - Executive VP & CFO

Yes. But overall, I mean, it's not the largest part of that customer group, you should be a fair assumption from.

Brady Connor - Verizon Communications Inc. - SVP of IR

Okay. And then what was the second part of the question, Frank?

Frank Louthan - Raymond James & Associates, Inc., Research Division - MD of Equity Research

So with the gross adds that you're getting, are there any characteristics about these customers you're tracking today that are maybe different from what they were, say, 2 years ago. And I'm curious about what you think about the long-term churn characteristics of customers you're tracking today, particularly given the heavier promotional activity that you've done versus what you did historically?

Hans Vestberg - Verizon Communications Inc. - Chairman & CEO

In general, I think the churn characteristics, all the new customers coming in is even better than before for many reasons, as you said yourself. And then the type of customers, I think Matt talked a little bit on the type of gross adds we're getting is new customers to Verizon, where they come in. And of course, we have opportunities to upgrade and step up them and also having opportunities for our converged offerings. So really good quality of the customers coming in, as Matt said as well. So we feel really good about the growth momentum we have and the customers we are getting.

Brady Connor - Verizon Communications Inc. - SVP of IR

Yes. Thanks, Frank. Brad, that's all the time we have 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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