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VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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PRESENTATION

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

All right, good morning. Good morning, everyone, and thank you for joining us for our fourth annual summit.

And thank you all for the support you've given us as a firm. Some of you who saw our last session with Disney heard Michael say the same thing, but all of us, on behalf of the whole firm, we can't thank you enough for the support of -- that you've given us. And it's hard to believe that we're now in our fourth year doing this. And thank you for those of us who -- those of you who are joining us via webcast this morning.

I'm really delighted to have Matt Ellis joining us this morning. Matt, congratulations again on your new role.

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

Thank you.

QUESTIONS AND ANSWERS

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

Obviously, one of the themes that we're going to talk about a lot throughout this conference -- and I know, the topic, just judging by the question I get, everybody wants to talk about M&A. I'm going to talk about that with you a little bit, but I want to start with the most recent transaction, Straight Path. And I wonder if you can just tell us, what was it that was so compelling about Straight Path? There was a sort of sense of urgency about getting Straight Path. What's so compelling about it? And what do you plan to do with it?

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

Yes, so good morning, Craig, and great to be here.

Before I start, I think we have our safe harbor slide, which I need to reference. If we can put that up, please. We'll get that up here in a sec. And I'll make reference -- obviously, we'll make forward-looking statements this morning, and there's obviously risks associated with that. The full statement is on our website. So with that said...

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

There.



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

Matt Ellis - Verizon Communications Inc. - EVP and CFO

There we go. There it is in all its glory. So with that said, to get to your question, as you think about Straight Path, I'd suggest you think about it in terms of the overall ecosystem of building out 5G, and really, the journey we've been on for the last 2, 3 years now. When we first started on this, we talked about we felt that there was some great use cases around 5G. And there was a lot of talk, well, the standards aren't going to be there until 2022, 2023. And we said, well, we think if we put our muscle behind, that it doesn't need to be that long. And so we partnered with other carriers around the globe, specifically in South Korea and Japan. We've partnered with some of the network manufacturers such as Samsung and Nokia and Ericsson, and you're seeing us really make a lot of progress there. We've tested the technology first in the lab, and then last year, we took it out of the lab into the field. And then this year, obviously we're doing the precommercial scale trials that we're just kicking off now. So what you see us doing is really building out what we need to launch 5G as we go forward. And obviously, one part of that is the spectrum. And so we have some 5G, the millimeter wave spectrum, through the XO transaction. That got us 28 gigahertz spectrum in significant parts of the country but not all of the country. And then when you look at the Straight Path asset, they bring more of that 28 and also nationwide coverage at the 39-gig level. So it was really a case of adding another asset that's -- we're going to need to build out 5G and be able to deploy it as quickly as we want to. There will be other 5G spectrum that comes available through FCC auctions, but that's a -- probably a couple of years away. And we felt like taking the uncertainty off the table, anticipating having to wait to participate in the auction, we now know what we have. And it puts us in a position we can deploy the 5G solutions as soon as they're available.

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

And is it fair that -- I presume the answer to this is yes, but that your engineering tests have been sufficiently positive to say, look, this is actually going to work for issues like rain and trees and leaves and that sort of thing that you're confident that there's a real business case for deploying the spectrum?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Absolutely. So that was part of the taking it out of the lab last year and doing some of the field trials. We demonstrated that it works. We demonstrated that you can deal with some of those issues and how you do the beamforming as you operate in these much more high-frequency bands, which is different than our traditional spectrum. And so we proved that you can solve those initial challenges that people saw, to the point we said, right, we're going to now test it on a larger scale, which is what we're in the process of launching right now. We're doing that in 11 different cities, which have different topographies, so we get comfortable with how that you use this spectrum and make it work. And then we'll deliver the business cases coming out of that. So those trials are just starting, too soon to tell you how they're going. I'm the most eager person to know. But we should have answers out of that as we get later into the year, and then we'll talk more about specific use cases. Obviously, we think the fixed wireless broadband is -- will be the first use case. And then after that, we'll get into mobility use cases as well.

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

Well, I'm going to come back a little bit to fixed wireless broadband later, but I want to start with the core business. In wireless, it's fair to say the first quarter, not just for you but really for the industry as a whole, was a very challenging quarter and with slow growth in phones but also ARPU's down. And I think it was the industry's first-ever year-over-year service revenue decline after 17 years of growth. Competitive intensity, I would argue, is probably the highest we ever saw in the first quarter. What's the argument that it gets better, first, for the industry as a whole and then for you specifically?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes. So I would say -- look, I'll talk about where we are. And we feel good about where we are today in the industry. You have the combination of the best network and the largest base of customers. And so what you saw us do in the first quarter was launch an unlimited -- because we've reached the point where customers were having to make a choice. Other carriers had decided to launch unlimited, and it was leading our customers to make the choice between, "Do I want that feature function where I don't have to worry about how much data I'm using anymore? Or do I want



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

to be on the best network?" And so what we did was we launched unlimited, and customers didn't have to make that trade-off anymore. And we immediately saw a benefit in the results. And as I think we said on the earnings call, I fully expect that we will be phone net add positive during the second quarter. So where we've certainly seen a turnaround in the business since we launched that. The other key component around this is, when we made that change, it wasn't a price reduction. I mean there are certainly customers optimizing and taking advantage of it and -- but there were also customers stepping up to it. So overall, we think that this will not be negative to ARPU by going on unlimited. And it was really just getting on that same level playing field from a functionality standpoint and going from there. So we like where we're positioned today. We're still premium priced. I mean we launched it in a disciplined fashion. It's at a premium to where the market is because we have the premium network. So we like where we're performing today.

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

Have you seen any sign that -- the competitive intensity that was -- that made the first quarter soft for you and everyone, have you seen any real signs that that's abating in any way? And what should we be looking for? You said phone net add positive, but what else do you look for to say the business is starting to turn?

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

Yes, so look, from the competitive environment standpoint, it's certainly been a competitive industry not just in the past year or so but at various times over the last 20 years. And I think, if you look where we are today, it shows that we compete effectively even in that type of environment. But we'll see how the industry plays out the rest of the year and if it gets more aggressive or less aggressive as different devices come out, we'll wait and see. But from the service -- let's talk about service revenue for a second as an answer to your question. First quarter, we saw the negative 6.1% year-over-year. And we said we expect second quarter to be in that similar type of range. But then we said we expect the back half of the year to show improvement in that trend. And so if I break that apart a minute and maybe explain why we have that confidence, you'll see that improve. If you look at the different components in service revenue, one of them is the line access fee. So if you go back to August of 2015, when we launched the price plan where we introduced small, medium, large, extra-large sizes, that was when we said we're not going to be fairly even on customer choice between the subsidy model and device payment model, we're really going to go more to device payment. And when a customer went to device payment, you go from that \$40 line access fee to the \$20. Now you're collecting the revenue elsewhere in equipment revenue, as you know, but from the looking at the service revenue, you've got that trade-down. So when we get into the third quarter of this year, we have the 2-year lapping of that really getting behind that, and so the headwind in the line access component of service revenue will be less when we get to the back half of the year. And then the overage component. Again, in the third quarter a year ago, we added features to our plan with safety mode and carryover data that started to allow customers to manage their overage more so than they could in the past. And obviously, that's a significant feature of unlimited as well that you get there. So we've seen significant migration of the base to both the plan we launched last summer with those features and now certainly with unlimited, and so we'll start to lap the anniversary of that as we get into the third quarter as well. And so the headwinds in both the line access and the overage will start to reduce as we get into the back half of the year. And the other thing that we're seeing is we're seeing customers in the base step up to get to unlimited. Whereas previously they'd say, I'm not sure I want to pay an extra \$20 a month to get an extra 4 gig of data, they'll say, Well, I'll pay an extra \$20 a month, and I get unlimited. And we're seeing more step-ups that way. So when you add those things together, the reductions of those headwinds that we see line of sight to beginning in the third quarter, we're confident the service revenue trajectory gets better in the back half of the year.

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

And do you actually -- so I -- we tend to do an accounting adjustment for ARPU and service revenue. I suspect you internally do the same so that you can get a sort of apples-to-apples view. I don't know whether you do it the same way we do. But do you think -- adjusted for the downdraft that comes from transitioning customers to EIP, do you actually get to positive ARPU growth in the back half of the year?



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

Matt Ellis - Verizon Communications Inc. - EVP and CFO

I think it's -- we certainly see the ARPU situation improve. And the exact timing of that getting to growth, we'll see whether that comes in the back half of the year or whether that gets to sometime further out in the future. But it depends a little bit on how things play out. But to your point, that's why we also look at service revenue plus installment payments. Because what I'm really interested in, irrespective of how I bifurcated the bill out and all the mess we've made with this, you get to what's the total amount of billing the customer monthly. And again, in the first quarter, even though service revenue was down 6.1% year-over-year, the billings, well, it's the service plus installment billings, were up on a year-over-year basis. So that's another reason why we feel good about the business.

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

Okay, good. So then let's talk about your network now because you talked about going to unlimited. And the big controversy, I think, that I hear from investors is whether the network is ready to handle the kind of load that you're seeing. So I guess the first place is, just at a 30,000-foot view, how is the network holding up as unlimited data usage ramps up? And the -- I think the argument was you probably only saw, because it came late in the quarter and people had to opt in, you probably only saw just the front edge of the increase in volumes that you're going to see over the rest of the year.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes, yes. The network is performing great, and it's performing as we expected when we decided to launch unlimited. We started thinking about unlimited last year. We weren't convinced we were going to do it, but we -- obviously, as it was in the marketplace, we asked ourselves is it something that we can do if we want. And obviously, the core brand promise that we make consumers is about the quality of the network experience. And so we said very early, as we started to think about unlimited, well if we're going to go there, we're not going to jeopardize that brand promise. So we're only going to go there if we're convinced that the network performance can continue to lead. And so the network team was confident in that they spent a lot of time in the back end of last year convincing the rest of us that the case. And so when we decided in the first quarter, where we saw the competitiveness in the marketplace and we were seeing customers really looking for that functionality, we'd reached the point where we felt network was there. Look, if I break down network, and I understand where the question comes from, we think about network in terms of coverage and capacity. So we completed, really, the build-out of coverage of the LTE network really about 3 years ago now. And since then, we've been adding capacity. And there's different ways you add capacity. There's -- we think about adding capacity with spectrum. We add capacity with the network architecture. And then we add capacity through densification. So from a spectrum standpoint, we continue to deploy more spectrum to our LTE network. Today, we're running just over 50% of our spectrum assets are supporting the LTE network. So there's a significant amount of spectrum we still have to deploy against the current network, whether that be the AWS-3 spectrum, which is starting to go into service this year, whether that be refarming PCS and 850-megahertz spectrum that supports the 3G and voice networks. As we get customers migrate off those, we refarm that spectrum over to the LTE network. And then as I think about heading into 2018, we're going to get access to unlicensed spectrum too. So we are continuing to add spectrum assets to the network. But then you get to the network architecture. And whether that be some of the features in LTE Advanced or whether that be what we're doing with CRAN and those type of technologies, we are more efficiently deploying the spectrum today than we were 5, 6 years ago when we launched the LTE network. So every piece of spectrum we have is doing more now and capable of doing more. And we see further opportunities to have gains just through the architecture. And then you get to densification, and we're doing exactly what we said we'd do. Remember we came out of the AWS-3 auction, and there were some cities that we didn't win, and we chose not to go. We said there's a price at which it makes more sense to add capacity through densification versus just spectrum. And we've done what we said we were going to do by densifying the network. And you've seen the network performance in that time period since then continues to lead the industry. So densification very much works. There's still a lot for us to do with densification. And a couple of other plus points about densification. One, it prepositions the network for 5G, because by putting the small cells in, putting that Dark Fiber in, you're creating some of that backbone that you're going to need for that next-generation network. And then secondly, it's more efficient to densify than just to add capacity through spectrum. For example, here in New York, it's certainly a market where we've had to add capacity. If I'm going to do that through spectrum, I've got to buy a piece of spectrum that covers -- yes, it covers Manhattan, it covers the 5 boroughs, but it covers areas outside that too. I may not need additional capacity throughout that geography. When I do it through densification, I pinpoint a specific location, like maybe right here, and I'm able to add capacity here without adding capacity where I don't need it, which is obviously less efficient. So we're very comfortable with the network performance in unlimited. And we're seeing what we thought we would see when we decided to go all in.



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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

So one of the arguments that I think everybody here will be familiar with is, notwithstanding all the things you said about the ways that you add capacity, there's still a broad perception that you are spectrum constrained and that particularly relative if you take metrics like megahertz POP per subscriber and that sort of thing. How do you -- so say more about how you think about spectrum. It used to be you would say I want to make sure I have spectrum to plan ahead 12 to 18 months. Is that time frame still appropriate? And are -- how confident are you that you do have the spectrum assets that you need?

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

Yes, so we still plan ahead. And that 12- to 18-month window is still the right one that we forecast where we see demand going and we see where we have capacity, and then you come to see where that equation looks like it's going to break, and then you architect a solution. And that solution's going to differ by geography. I mean, in the old days, it used to be I'll just -- I'll put up another macro cell site. And I have to have the spectrum there to make that work. Now it's a question of, okay, how am I going to use small cells? And there's different types of small cell solutions. So what's the right solution for the geography where you're going to need to add capacity 12 to 18 months out? And we had a -- we showed a video at the sell side event last week that's available on the website where you can -- we showed 3 different geographies and how you're densifying in different ways in those different geographies because of the specifics of each location. So the team continues to do that 12 to 18 months out. That's what they've been doing. The things the engineers are deploying in the field today are things we started planning for in the first half of 2016. And the things that we're planning today is for activity we'll actually deploy in 2018. And that continues to be the case. Spectrum is one way that we can add that capacity, but it's not the only way. And I say it's really about looking at where we think we see we need additional capacity 12 to 18 months out, and then we find the right solution. And that is often as much around densification as it is around I need more spectrum in that particular location.

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

And so the densification story has been a somewhat slower one for almost everyone than I think we would have anticipated a couple of years ago, whether it's zoning, whether it's the cost of roof rentals and street furniture rentals and that sort of thing. Can you talk about the pace? You said you're planning 12 to 18 months in advance for getting that done, but how long does it take to scale a small cell network in a given location?

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

Right. You -- I mean you touch on some of the points that are there. I mean certainly the zoning and permitting and so on takes time, which is why we plan that far in advance so that we can get it done. And that's we are -- I think we know how to do that. We've been doing it for a long time, and we've shown that we can get there. I don't think -- you don't just go in and say I'm going to densify a city and say, okay, it's done densifying. There's layers to that. You go into initial densification, and you come back and you densify further and so on. So it's continuous how we do that in different geographies, because you're adding the capacity that you're going to need, some far out in the future, 18 to 24 months out, but I'm not necessarily trying to put the capacity I'm going to need 10 years out. That would be a little inefficient to deploy it that fast. So -- but the reason why we do it, that timing, is just the timing to get the permits, to work with the local authorities to get there. I think we know how to do that now, and I think we've demonstrated that. That's why we've added the amount of densification we have in numerous cities across the country. And you see it in the network results.

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

And so is it fair to say that's becoming a more and more important part of your capital budget?



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

Matt Ellis - Verizon Communications Inc. - EVP and CFO

The densification piece?

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

Yes.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes. I think, when you look at the capital budget, overall, the number stays fairly consistent. But what is -- in there evolves significantly over time. If you think -- if you go back a number of years, obviously, it was around 3G. And then it shifted to FiosFios, and then it shifted to 4G. And even within 4G, it's moved from initially, it was about coverage, to now it's moved to capacity. And within capacity, it's -- there's a fair amount of that, the densification. And as I said earlier, we're thinking about it not just deploying densification for 4G but how as you put that densification in, we're repositioning for a 5G deployment as well. So we make that asset deployment as efficient as possible.

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

And so bottom line, I guess, for me and for a lot of your investors is, is the core Verizon strategy of network advantage in wireless still possible? Is there still room for network advantage to be a differentiator? And do you still own that position?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Absolutely. And I think that shows up in the numbers we saw in the second half of the first quarter after we took away the functionality difference, unlimited versus not unlimited. And you saw the numbers we had in the second half. And that's with the price premium against where some of the other guys are. So it shows that consumers understand the value of the network. They're willing to pay that premium to get on the Verizon network experience. And we fully expect to continue that. And we're -- as I think about not just in 4G LTE but as we get to 5G, we're confident that we are leading the way there. We're going to deploy that first and continue that history of that network leadership.

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

So let's talk about 5G for a second. You mentioned the trials that you're already doing and that it may be too early to report anything back on what you're seeing, but what's your intuition about -- let's take fixed wireless broadband for a second -- what's your intuition about the geographies where it's going to make sense? Does it make sense only in extremely dense markets? Does it make sense only in sort of in the suburban rings around dense markets? Where does the business case play out for fixed wireless?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Yes. So I think what it ultimately depends on is how far you can kind of propagate that signal, right? And that's really why we're doing the trials, to get comfortable with how far. That really says how far out in that dense urban to suburban ring and so on it makes sense to go. So we'll have more sense later in the year on that -- on the size of that particular opportunity. I -- we certainly think it's significant. We certainly think it's a meaningful business case. And we look forward to getting to the end of the trials and being able to be a little more specific about that. But we don't believe at this point it's just a dense urban opportunity. We think it moves a little more broader than that.



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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

And like in the case of building a wireline network, is it, I'm guessing, advantaged in places where there's aerial infrastructure relative to buried infrastructure? And presumably, it's easier in places where there's telephone poles or street furniture than in places where there's not and -- or is the street furniture, which I guess has become the euphemism for street lights?

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

Right. Yes. So as you think about it, and really what -- I may take you back on this one -- is what we're doing in Boston, which is about the value of a fiber network across multiple usage and architecting that network to provide multiple uses, whether it's connecting cell sites, whether that's a 4G cell site or becoming a 5G cell site; whether it's providing a residential solution, as we are in the Boston build with the Fios product; whether it's connecting small businesses or enterprise businesses going into the tall buildings in the center of the city and connecting those up for enterprise solutions. And then even as we move forward here, how do you connect up with these smart city solutions, the kiosks that are out there that we see in a number of cities now, just walked past one on the way here this morning, right? And then the smart lighting solutions and traffic cameras and the like. And so it's a case of putting that fiber in that's going to support those multiple uses, including the 5G business case. And when you -- if you think about that fiber going out and using the street architecture and as you say, aerial plants easier than, obviously, when you have to go dig the ground. But it's the combination of those things. And I think we've also learned how you go -- even when you have to put the fiber below ground, we now how to go do that as efficiently as possible.

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

Lowell has talked about the architecture that you're using in Boston. And Nick and I, some of you may have seen, just published a pretty extensive report on the 5G architecture, our small cells part 2 piece, that suggests it's a pretty expensive proposition to start doing 1,700-strand sheaths in lots of different geographies. Is it a fair expectation? You said before that the mix within your capital budget changes over time. But is it reasonable to assume that as you start to build extensive 5G, that it's going to have to take just plain more capital spending, that it's a more capital-intensive business than what we've seen so far?

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

Yes, I don't know if that's -- I wouldn't necessarily say that's the case. I mean we're going to have to see. We'll get through the trials and we'll determine the size of the opportunities we discuss. And then we'll decide how quickly we decide to deploy against that. So I'd say more to come there. But I'm not sure that I'd say that -- that's not a foregone conclusion by any means.

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

I'm going to wrap up on wireless with just one last question, and that is your margins in wireless have consistently been the envy of everyone in the industry. But that's both a blessing and a curse, right? I mean there are some who would argue that we've seen peak margins. They'll never be sustainably that good. There's others that would say, no, you've actually got -- as the upgrade rates stay low and you keep taking costs out of the business. How do you think about those 2 things? And how do think about the margin trajectory of the wireless business as you look out?

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

Yes, I like that question. We've -- I think we've got it for a number of years now. And we keep getting asked it because we keep producing the margins, right? So look, it's about continuing to improve the efficiency of the business. And we don't always talk about it probably as much as we should do, but there's a number of ways that you see us continue to improve the cost side of the wireless business. It starts with network. And as we deploy the network more efficiently this year than we did last year and the year before that, the cost per bit comes down. And we're constantly doing that. And that's been something at each generation of the wireless industry that you've seen us do that. The first year of any of the generations



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

is the most expensive cost per bit, and then it continues to come down from that. And we could see a continued line of sight with the LTE network to continue to bring down that cost per bit through the remainder of this year, next year and going forward. So the network piece, we think, continues to get more efficient. And then as you think about other parts of the cost structure, from a distribution standpoint, we think there's still opportunity to reduce the cost of the distribution side by making distribution more of a digital-first activity. And so there's opportunities there to continue to reduce the costs there. And then on the customer care side, we continue to work and understand what's causing customers have to call and take away those reasons that's causing it -- causing them to call. And if there are things they need to do, how can they do that in a self-serve fashion? With the app we launched last year, there's a number of things that a customer used to have to make a call, and they can now do on their own time and just take care of themselves. So...

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

And is it fair to say that a customer who's on an unlimited plan has a lot fewer reasons to call?

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

Yes. I mean there's obviously less things they have to call about, so that helps the cost side of the equation. So there's a number of levers there to continue to drive the cost side, whether it's the network, distribution, care, other things too. So that's an every year activity for us. It's not just kind of a one-off program.

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

Now it used to be in these interviews, we would say, "Now let's turn to the wireline business," but in some ways, the wireline business isn't really a separate business anymore. A lot of what you've been talking about is really the integration of wireless and wireline, so let me step back for a second, because you've divested a lot of your wireline assets to Frontier in a couple of sequential transactions. But on the other hand, you seem to be increasing your dependence on wires. Can you talk about that trade-off of, on the one hand, coveting wires whether from someone else or building more, and on the other hand, divesting some of what you already have?

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

Yes. So I'd start off with saying we still very much do have 2 segments, how we think about go to market. We go to market with wireless products and services, and we go to market with wireline products and services. That's not fundamentally changing. What you're seeing change a little bit more is the network, the provisions there. Historically, we've talked about the wireline network and the wireless network. And as you said, that's where you're seeing more convergence. Because the wireless network, the reach of fiber into the wireless network, or wires in general, is a lot more than it used to be as you move from a macro cell site network to one with more small cells in it. So what's important to our -- the products and services we offer, whether that's a wireline or a wireless, to a wireline or wireless customer is the quality of that fiber asset in the underlying network architecture. And so you've seen the things we've done around that. And certainly, we've talked a little bit about Boston and how we're building the network there. And you should think of that as a blueprint for how we're building fiber in other locations as well. You mentioned we've divested some assets. Obviously, the last one was the 3 geographies that we divested to Frontier last year. What we really did is we took those properties that still had a large amount of copper in them, we divested those, and we took the proceeds and used that to buy the XO asset, which gave us fiber metro rings in 45 of the top markets around the country. So we are certainly committed to the wireline asset. It's the foundation of the networks, both to provision wireline and wireless, and in addition to obviously buying assets like XO, you see the agreements recently with Corning and Prysmian to spend \$1.3 billion over the next 3 years buying fiber. So we're committed to the wireline business because it's -- really, it's the backbone of all of the network services that we're offering.



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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

One of the alarming numbers to me that I saw in anybody's first quarter report was the decline in the -- the rate of decline in AT&T's wireline business, in their commercial wireline business. Yours was much more of a constant trajectory, that it's been a -- it's not an easy business, but they had a very steep acceleration in their rate of decline in commercial wireline. Are you seeing -- what are you seeing? Or is that a canary in a coal mine for that industry, and that segment as a whole is getting more challenging?

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

No. I think we're seeing the continuation of the trends you've seen in our results for the past few years now. And so we've done a couple of things in that space. We've, first of all, at the start of this year, we talked about we'd broken up those customer segments. We used to have what we called consumer mass business and enterprise. And within that, you had -- within consumer mass business, it was obviously consumer was the primary focus. And then within enterprise, certainly the larger customers were the focus. And so what we did, we brought the mass business out of the consumer piece. We brought the more medium-sized business out of the enterprise and formed that new customer group. And they're very much focused on the SMB space, including state and local government and education institutions. And so now that you've got a group that's very focused on that category, we're developing product offerings where you may bundle the voice and data needs of those type of customers in a product that fits for them. And we're optimistic that, that will help us to offset some of the secular declines in just from legacy voice and data or from copper-based services. When you get to the enterprise space, yes, you've got some of those secular declines that we've seen now for a few years. But I think we've been the first to deploy some of the SD-WAN products in that space and seeing great take rates from customers. And so we've got those product offerings out there, sort of network virtualization offerings out there, that are really allowing us to grow those businesses that offset some of the secular decline. And so we're confident that the revenue trajectory we've been on will still be in that low single-digit negative number where we've been. But we see the things we're doing in terms of new products and services providing enough of an offset to the decline in the legacy that we don't see any significant like downward trend that you discussed.

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

And what about in the consumer business? What's the future of Fios for you?

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

Yes. Fios is a great business. I mean it's -- I think you see in this quarter, we've added some things with -- around the Gigabit Connection...

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

And has that had real traction?

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

We're seeing some traction certainly. But what we've got is, and it continues to be, because of the symmetrical upload and download speeds, it's -- we believe it's a superior product to other products that are out there. And when we put the right offering out there around it, we see it resonate in the marketplace. So it continues to be -- and broadband is going to be very important to the home connection going forward, more so today than it was yesterday and more so tomorrow than it is today. Customers are -- continue to connect more devices in their home to their broadband network. And so having that broadband network that can handle all those connections on it is incredibly important. And we think the Fios network gives consumers the best broadband network that -- to handle all of that.



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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

And so that -- I take it that is still a business that you see as strategically core.

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

I think offering broadband in-home solutions is still strategically...

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

In the sort of fortress Northeast, as I've always...

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

Yes, at this point in time, certainly, in the Northeast is where we've got that footprint. And so we think that continues to be a very important product.

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

And I guess, the same question I asked about on the wireless side, wireline margins have actually been one of the untold stories. You've actually had a nice turn in wireline margins. How much more runway is there for wireline margins? Or lapping the Frontier transaction, have we now seen most of what we're going to get?

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

Yes, we said we would take out the stranded costs with the Frontier transaction. The teams worked well there. You're also getting to the point this year where you kind of lap some of the benefits coming out of the labor contract last year. But we've said, and certainly, the first quarter came in a little north of 22%. We'll see fluctuations in the margin throughout the year, as we typically do in wireline, but for the year as a whole, we certainly think it'll be better than a year ago, be in the low 20% range. And we'll continue taking costs out as we go forward. I think the wireline team, because of some of those secular declines that we talked about have been out there for a while, the team really knows how to continue to attack the cost side of the equation. And you see that. And that's why you see the results in the margins you do. So we think, as I say, it'll be in the low 20s. And we'll see what we can do next year on top of that.

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

I guess the one last thing we haven't talked about yet within the portfolio is AOL and Yahoo!. Is that big enough to move the needle as a growth driver?

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

Yes, absolutely. I mean so just -- the day we close, when you take the 2 businesses, even without any integration benefit, it's a \$7 billion business on an annualized run rate. So that's not small by any means. And as you heard Tim talk about last week, his goal is to get by the -- by 2020, up to around \$10 billion or so. So that business has the ability to move the needle. We think there is tremendous advantage of bringing the Yahoo!, the eyeballs they have, the content platforms they have into -- merge that with the AOL content. And then you've got the ad-tech platform underneath that's the challenge today with the current business is just not having as many eyeballs there as we need to drive the growth there. And when you bring that volume of eyeballs that Yahoo! has and you start building out these super channels that we talked about around news and sports and finance and tech and lifestyle and so on, there's a tremendous opportunity to build a very good platform. Tim likes to talk about building the brands



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

that consumers love and building platforms that companies love, and that's the challenge that the team is working on. They've got a great integration plan. They're ready to go, and we look forward to closing and getting on with it.

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

We were joking about Game of Thrones before. And there's certainly a sense pervading this summit of that there is this sort of pendency of a huge wave of M&A coming. Your strategy has been pretty different than -- certainly than AT&T's but than a lot of peers and a lot of what people expected in that you've done a series of what, by contrast, are relatively small deals now, with Straight Path but previously with Yahoo! and then going back to AOL. Nothing like the kind of giant deals that some people have speculated about. Before we talk about what some -- that piece of it, when I look across the portfolio, can you get this business back to consolidated, GDP-like growth without big acquisitions?

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

Absolutely. And look, you start with service revenue in wireless. Obviously, that's the biggest part of the business today, and just moving that piece. So we've talked about some of the headwinds that are in the service revenue piece right now that we have line of sight to as we get to the second half of the year, start to dissipate. So excited about that. Certainly, with the change in the customer acquisition metrics pre- and post-unlimited makes us feel good about the impact on service revenue in wireless. So as we said, we expect service revenue trends to improve in the second half of the year and get back to where year-over-year numbers during the course of 2018. So that will be a significant move from what you've seen over the past year or so. Wireline, we've talked about we think a lot of the trends there are you're going to see what we've been seeing. And then the growth from the new businesses, we certainly think the combination of AOL with Yahoo! will not be a \$7 billion business. It will grow significantly from there. And then even telematics, with the acquisitions we did last year, that's now a business that's at about a \$1 billion annual run rate from a revenue standpoint with significant growth ahead of it. So you add all those things up, and we certainly see that there is a path to revenue growth as you go forward here, as you just kind of work through those headwinds over the course of the next few months and quarters and you get back to just the businesses we now own and closing Yahoo! and being where we need to be.

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

So now let's talk about the topic everybody wants to talk about. We've made jokes about whether it's the dating game or Tinder or all those kinds of all the different combinations that everybody wants to make for everybody else. And everybody is playing Billionaire Matchmaker here. You've been matched to wireline assets, to cable operators, and to be fair, you as a company didn't go out of your way to dispel the idea that you might be interested in buying cable. You've also been speculated as a buyer of big spectrum assets. You've been speculated as a buyer of content companies. Talk about each of those things, if you will, and just kind of how you think about the sort of strategic sufficiency of the portfolio and what each of those things might bring.

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

Yes. So let me maybe take it to a high level first and think about, talk about how we think about M&A in general. You start with you have the strategy of what it is you're trying to do with the business, how you're going to grow the business going forward. And then the question becomes does M&A provide an opportunity to accelerate the execution of that strategy and do it in a manner that generates additional shareholder value versus just organically building and executing that strategy.

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

So that seems like that's distinct from saying we're not -- we're not talking about M&A as diversification. We're talking about it in service of our existing assets. Is that fair to say that's the guiding principle?



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

Matt Ellis - Verizon Communications Inc. - EVP and CFO

I would think that we always have to articulate how M&A fits with the existing strategy of the business.

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

Okay.

Matt Ellis - Verizon Communications Inc. - EVP and CFO

And so when you apply those 2 screens of does it accelerate the execution of the strategy and can you do it in a fashion that creates shareholder value, a large number of opportunities don't survive going through those 2 screens. And so you've seen the things we've done. And it's been different to what some other folks have done. Look, in the -- certainly, as we think about kind of network assets and fiber assets, we've talked a bunch over the past few months about why we think fiber is important, the fact is there's a lot of fiber that's out there but it's not really the fiber that we're looking for to execute our strategy and how we want to build the network. And it's kind of this converged fiber network that we've spoken about. So look, if there's an asset out there that allows us to accelerate the deployment of that in a way that creates shareholder value, we certainly would look at that. But as you heard Lowell said in the TV interview he did a couple of weeks ago, we haven't seen anyone who's got the network architecture that we're looking for. And certainly, by the agreements that we talked about with Corning and so on, that we've shown that we're certainly comfortable just organically adding to that network capacity to get where we want to go. And I think that same type of thinking applies across other spaces too.

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

So spectrum and content, same concepts?

Matt Ellis - Verizon Communications Inc. - EVP and CFO

Look, spectrum, so as it relates to LTE, as I think about spectrum, you say, Okay, I know I need to continue to add capacity to my LTE network. We talked a lot about that earlier. And I can do that by adding spectrum. So we've said all along that spectrum at the right price is certainly something that we would have a conversation about. We buy spectrum in the secondary market all the time. We did a number of transactions last year and continue to do so. So spectrum at the right price is certainly something we do. But we have other opportunities to densify the network and get where we need to. When you move to 5G, we said we don't have the spectrum that we need. We're not sure that we want to wait for an auction, and the certainty around timing of that, and you don't know how an auction's going to play out. So we said, let's go ahead and go get that spectrum, and certainly, we've done that through both XO and now Straight Path so that we can execute our 5G strategy on the time line we want to and not have to wait for the asset to be available. And then as you think about content, look, the content industry is changing. You -- we've all talked a lot about some of the pressure on linear TV. But just because there's that pressure there doesn't mean consumers are consuming less content, they're just doing it in very different ways. And certainly that, as we bring AOL and Yahoo! together under the Oath brand, we think that will be a significant platform at which consumers come and consume content. Some of that content, we own. We own some today through AOL has with things like HuffPost and TechCrunch and so on. And certainly Yahoo! has a good amount of its own content, but we're also confident that with the ad-tech platform, we can participate in the monetization of that through digital rights and not having to own all the content that comes through there as well. So look, we're constantly looking at how the content is evolving as the way people consume is evolving, and we'll see the best way for us to participate there. But we're happy getting digital rights as we do today and using that as the way that we can then monetize it through the ad-tech platform.



MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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

So I want to wrap up with a question about the balance sheet. There was just the 8-K that came out, what, a week or so ago about the S&P change in targets. Is there anything you can add about the trajectory of your leverage ratios and your targets?

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

Yes. Really, there was -- all that was really about was the trajectory hasn't changed. As we said in the release, we remain committed to a strong balance sheet with improving credit metrics. And so I don't see a change in the trajectory. The reason why we issued that 8-K was because S&P sort of changed their view of the industry and therefore their requirement to get to that higher credit metric moved. And that was one we saw -- we're not sure our trajectory was on line with that new number, so we felt it was the right thing to do, to communicate to our investors. But the way we're managing the balance sheet hasn't changed as a result of them kind of changing that metric. So I continue to expect that I'll see the same improvement in the credit metrics that I would have done if they'd left that threshold in the place they previously had it.

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

And we're just about out of time, so I want to leave it for you to -- as you look out at the audience, you've got an awful lot of either shareholders or potential shareholders here, what do you think that they might not understand or should understand better about Verizon? And make the case for why, at this valuation, they ought to own Verizon.

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

Yes, look, I see tremendous opportunities across our business as we go forward, and that's on many levels. Look, and it starts with the portfolio of network assets we have that allow us to be the network leader today but also as we get into next generations of technology. So we have the best LTE network. We have great fiber assets. And we are leading the way as we go to 5G, undeniably so. So when I think about that, network is the foundation of the strategy and allow us to do the things and at a faster pace than, I think, a lot of the other folks that we compete with. And so then when you have those network functions, both now and as we think looking forward, and you combine that with the base of customers we have, the products and services that we have the opportunity to develop and enrich people's lives in this connected world that we live in, we have the opportunity to do the things at a scale that I don't think anyone else has. And so that's a tremendous opportunity. Then you add in what we're doing with some of the new businesses, and so we got into those businesses, we got comfortable with them, and then we decided, okay, now is the time to add scale. So we've certainly done that. And we talk about what we're doing with Oath and what we're doing in telematics and those businesses coming together. So there's a number of opportunities for us to lead going forward and to generate significant shareholder value. And I look forward to being back here and we can talk about the progress that we've made. And I'm very confident that we're going to deliver on -- across that portfolio.

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

And I look forward to that as well. And I thank you for coming this year. And I thank all of you for joining us.

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

Thank you.

Editor

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MAY 17, 2017 / 1:00PM, VZ - Verizon Communications Inc at MoffettNathanson Media & Communications Summit

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On April 10, 2017, Yahoo! Inc. ("Yahoo") filed with the Securities and Exchange Commission (the "SEC") Amendment No. 2 to the preliminary proxy statement regarding the proposed sale of Yahoo's operating business to Verizon Communications Inc. ("Verizon") and related transactions. Yahoo will file with the SEC a definitive version of the proxy statement, which will be sent or provided to Yahoo stockholders when available. The information contained in the preliminary proxy statement is not complete and may be changed. BEFORE MAKING ANY VOTING DECISION, YAHOO'S STOCKHOLDERS ARE STRONGLY ADVISED TO READ YAHOO'S PROXY STATEMENT IN ITS ENTIRETY (INCLUDING ANY AMENDMENTS OR SUPPLEMENTS THERETO WHEN THEY BECOME AVAILABLE) AND ANY OTHER DOCUMENTS FILED WITH THE SEC IN CONNECTION WITH THE PROPOSED TRANSACTIONS OR INCORPORATED BY REFERENCE THEREIN BECAUSE THEY CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTIONS. Investors and stockholders can obtain a free copy of Yahoo's proxy statement, any amendments or supplements to the proxy statement, and other documents filed by Yahoo with the SEC in connection with the proposed transactions for no charge at the SEC's website at www.sec.gov, on the Investor Relations page of Yahoo's website investor.yahoo.net or by writing to Investor Relations, Yahoo! Inc., 701 First Avenue, Sunnyvale, CA 94089.

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Participants in the Solicitation

Verizon and its directors and executive officers, and Straight Path and its directors and executive officers, may be deemed to be participants in the solicitation of proxies from the holders of Straight Path common stock in respect of the proposed merger. Information about the directors and executive officers of Verizon is set forth in the proxy statement for Verizon Communications Inc.'s 2017 Annual Meeting of Stockholders, which was filed with the SEC on March 20, 2017. Information about the directors and executive officers of Straight Path is set forth in the proxy statement for Straight Path Communications, Inc.'s 2017 Annual Meeting of Stockholders, which was filed with the SEC on November 22, 2016. Investors may obtain additional information regarding the interest of such participants by reading the proxy statement/prospectus regarding the proposed merger when it becomes available.

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