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EDITED TRANSCRIPT

VZ - Verizon Communications Inc at Morgan Stanley Technology, Media & Telecom Conference

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PRESENTATION

Simon Flannery - *Morgan Stanley - Analyst*

Alright, if everybody could get seated please, we'll get started. So delighted to introduce Fran Shammo, Verizon's Chief Financial Officer. Before we get started, please note that all important disclosures including personal holding disclosures and Morgan Stanley disclosures appear on the Morgan Stanley public website at www.morganstanley.com/research disclosures or at the registration desk. So Fran, it's been a crazy couple of months already in the telecom industry; we've had the auctions, we've had the Title II last week, you've done a number of transformative transactions. So help us think about 2015 at large, what are your key priorities as a Company?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Good afternoon and thanks, Simon. First off, just want to remind everyone that our website includes our forward-looking statements so I just want to reference that. Now going into 2015, so our priorities and execution really have not changed. So post the Vodafone transaction, we said that we would continue to invest in our networks, our platforms, we would buy spectrum, we would delever the balance sheet; and I think you see us executing on those things. From just an overall strategy standpoint, we executed in the auction, I'm sure we'll talk more about that; we continued to build out our networks and our platforms. So if you look at just how we're progressing through 2015 coming out of the strong volume quarter of 2014, Lowell said it best back in about the second week of January that said look, we believe Verizon Wireless will get back to its historical margins.

Now having said that, there's a couple things fundamental behind that. Number one, we will continue in the marketplace to strive for quality growth. I think we've said coming out of our earnings call that we're not going to chase every customer based on price, Verizon Wireless is more than that. But I think we also have to look at we have an incredible base and the more we can give value to that base, the more value we can create for the shareholder and for Verizon Wireless. And things around, it's not going to be just about the net add anymore. If you look at things like Internet of Things and more of what you'll hear about coming this summer, which is our mobile-first over-the-top offering; these are not going to show up as net adds in the industry.

This is going to contribute to revenue growth. It's going to be attached into really our current base of 100 million subscribers, especially the over-the-top product. Internet of Things will open up many more growth avenues for us so if you look at just our to-date revenue around this category, it's almost $600 million growing at almost 45% year-over-year. So, this is a tremendous growth for not only Verizon, but also for the industry. So, we are looking at many different avenues for our growth and I think that will tell the story through 2015. We can probably talk more about the divestiture strategy in some of your questions. And then on the wireline, I would put it as it's just more of the same of what you saw in 2014; it's continuing to execute, it's continuing to overall year-over-year improve the margin of the wireline business.

Simon Flannery - *Morgan Stanley - Analyst*

So, that's a great overview. If we start with the wireless business overall and you talked about the targeting and focusing on the best value customers, how does that translate into churn, how does that translate into revenue growth? You put out guidance for some reasonable modest revenue growth in 2015, but is that more going to be ARPU driven or subscriber driven? And the churn was elevated for the whole industry, is that something that will help your margins get back to normal levels in the next couple of quarters.

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Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

I think the way we look at is we're looking at topline revenue growth. When you start to get down into the metrics like an ARPA or an ARPU, obviously the shift between the service revenue category and the equipment revenue category starts to play an impact on those metrics. If you look at it overall, we're saying that we're going to grow revenue about 4% topline. Equipment revenue will be a driver of that, but keep in mind equipment revenue now doesn't carry a subsidy so you're kind of displacing service revenue with equipment revenue. And really what we've strived to do through the economics of this with the customer is to make sure that regardless of what option the customer takes, the NPV of that customer is about the same at the end of the two years and that's really what we've strived for. That what's you saw when we made the change from the residual value of going to 75% in order to upgrade, it was all around the economics of the customer.

So when you think about topline growth, it's going to be driven by some of that; but then as you go into it, it's going to continue to be driven more by these other things that I talked about in the beginning which is Internet of things, over-the-top, mobile-first. Obviously within the account itself, the concentration rate now is one of the key metrics for us is to continue to look for that attachment rate. So, we exited the year at, on the account basis we now have three devices per account and that's going up 4% year-over-year and that's really a key for us to continue to drive the revenue model because as people continue to include the account and attach to that account, that will eventually drive more revenue in that. Now we've seen some compression because more people are buying the bigger bundles so you don't get the overages as much. We've seen some price compression through 2014.

But if you think about that and you look at that, some of that price compression is just a shift to the equipment side so you have to look at the whole puzzle, you can't just take a piece of it or else it's going to lead you down the wrong path of our growth. And I think that's the important thing. The other thing is as we continue to drive this, we will continue to drive for scale and efficiency so that Verizon Wireless can get back to that margin that everybody's used to and we think we'll do that at the end of the first quarter. So you combine all of that, I think that's really where we're at. Now the industry competitively, I think we're just seeing more of the same that came out of the fourth quarter. I don't see it, I'm not going to say it won't increase competitively though 2015, but at this point it's pretty much the same as what we saw in the fourth quarter.

Simon Flannery - *Morgan Stanley - Analyst*

And you talked in your opening comments about your network first strategy, I think you've taken some new steps to try to help messaging that. You obviously had XLTE as a big message over the last few quarters and now we've got this hashtag don't settle and the whole millennial focus. Can you talk a little bit more about that and the opportunity you see in that segment?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

I think that there's a lot of claims being made by a lot of people around network and I think what we're trying to do is to differentiate because there's a lot of confusion as to what that means. From an industry perspective and at least from this room's perspective, everybody looks at root metrics as the third-party qualifier and hands down Verizon Wireless wins that every time. But I think from a general consumer, I think consumers are getting very confused as to what is the network quality. So, really what we're driving now is to say don't settle for less because network is important and when you're going to need it the most, you're going to want it to be there and I think that's what you're going to start to see from us and not more around --. I mean we know we're the most reliable, we know we're the best, but that message is getting confused within the consumer market so you're going to see us do some different things there in 2015 to differentiate what we mean by that and we think that will carry.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. So, I think you said that traffic per account was up 50% year-over-year so maybe we can just talk about handling the capacity this year and going forward. And in the auction you spent $10 billion, a lot of money, but you didn't get spectrum in every market. You decided to step away when the pricing got to a certain level. Can you help us understand how you went into the auction and how you kind of played this out in your mind about where you really needed spectrum and what you were willing to pay?

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Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

We entered the auction and when we entered the auction, we knew that the auction prices would be driven up probably more so than any previous auction. But probably midway through the auction, we realized that the prices were getting so high in certain markets, it just didn't make financial sense anymore to buy the spectrum in that market. And I think the best way to describe it, which is what Tony Melone did, was you have to look at a scale. In every purchase of spectrum up to this auction, the scale was that it was more efficient to buy spectrum than it was to build capacity because the scale was spectrum was cheaper to build on capacity. This auction flipped that equation in certain markets.

And so we became much more diligent on what markets we strategically wanted and we were willing to let other markets go because when you looked at it, if I was to get what I wanted initially when I went in, I would have spent an extra $6 billion when I could create the same capacity with $1.5 billion by building it. So, financially it made no sense to execute on those markets. Now I know that that's confusing because people think that spectrum is the Holy Grail and if you don't have enough spectrum, you can't have the capacity. But actually that's not true now because technology has changed so much. If you look at small cell technology, diversified antenna systems, and when you think around cities and take Chicago for example; if you walk down the street, you see small cells on lamp posts. So, the municipalities are starting to open up to that small cell technology.

Now granted it comes with an OpEx on it because you have to run fiber to that, but it still does not outweigh the benefits of building versus buying that spectrum and then there's endless capacity around that. So it's not like I didn't buy the spectrum today, I'm being held hostage by somebody else that I'm going to need their spectrum. Absolutely a false conclusion because if I really needed that spectrum, I would have bought it in the open auction, I wouldn't be held hostage to some third-party. So, I think at this point we're very satisfied with where we came out with the auction and we can execute on our capacity within the build program. And as I said, Simon, coming out of it, we gave guidance of $17.5 billion to $18 billion for CapEx next year and that included an additional $500 million to build out where we didn't get the spectrum, but that was built into the plan.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. So maybe we'll take that CapEx guidance, what are the other big priorities for your investment?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Well, it's all around wireless network and I've consistently said before, you should anticipate that wireless CapEx continues to trend up while wireline continues to trend down. Now within the wireline business, we still have legitimate LFAs that we have to complete in cities like New York, Philadelphia, DC. So, we still have to build out that FiOS which we will complete. But given that, that's kind of how you should think about CapEx. In addition to that, we're also investing in these other things that now Marni Walden leads up like Internet of things, like over-the-top mobile. If you saw what we did over the past two years where we developed Verizon Digital Media Services, we acquired EdgeCast, upLynk, then OnCue; that's the platform that Marni is developing to launch the over-the-top mobile video. So, we continue to invest in those things that we believe are the future growth of the Company.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. So you made headlines the other day with the sale of your tower portfolio to American Tower and the sale of some of the former GTE properties to Frontier. Can you just characterize the thought process in deciding to monetize those and talk us through how long that will take to close in each situation?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

So, let's start with the towers. So if you think, you got Lowell and I on record many a times saying look if it's the right term, if it's the right conditions, right price; we'll sell the towers and we finally got to that agreement with American Tower. The deal should close within the next 30 to 45 days.

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The proceeds should be received and it was a good deal for us. And we got the terms that we needed in there to protect our future rights of space on those towers so it was a really good deal for us and I think a good deal for American Tower. Let's go into the three strategic properties in the south, which consist of Florida, Texas, and California. And again, Lowell and I said for the right price, right terms that if there's an asset that we don't believe is as strategic to Verizon and it can return shareholder value, we will dispose of that asset and this is one of those assets. I mean if you look at Florida, Texas, and California; these are three island properties. The FiOS is a very small footprint of those properties compared to the copper footprint in those properties other than Florida because it was just Tampa.

But you look at that and you say strategically there's really not much we can do with those properties because they are islands. Obviously we got to a great deal with Frontier that made sense for us, made sense for them; and we said you know what, we can return value to our shareholder by executing on this deal. So with the proceeds of both of them, about $15 billion. Obviously the Frontier transaction won't close probably until the first quarter of 2016 as we get through all the regulatory approvals, but obviously Frontier has a good track record of getting that done with Maggie and her team and our team so we'll complete that by the first quarter. And for all those proceeds, we laid out the plan of how we were going to buy spectrum, do the share buyback program, and delever the balance sheet, which is the commitment that we made at the Vodafone transaction. So given that transaction and what we committed to, we are right on track with doing that.

Simon Flannery - *Morgan Stanley - Analyst*

I think you said the buyback is going to net about $0.07 to $0.09 EPS accretion this year, but then the Frontier transaction would be dilutive absent other actions, but I think you've talked about taking some steps to offset that. Can you help us get some more color on that?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

So, these three properties were higher margin properties than the rest of our wireline business and a part of that is because FiOS was such a large penetration. So if you look at Dallas, we were over 50% penetrated both in TV and broadband. So, it was a very highly penetrated market that was delivering a lot of cash flow and delivering a lot of earnings. So by just divesting of the three properties, if you just did it on an apples-to-apples basis, there would be dilution. But now, we have a year to plan for this and the plan is similar to what we did with the last time we rolled properties out from Frontier was we will plan to offset the stranded cost and those plans are already being worked. You saw a little bit of that in the fourth quarter where we gave some ISPs to the represented employee base and we had 2,100 people come off payroll. So, you already see how we're going to go through this year to make sure that at the time of close, we will have to offset the cost structure to make sure that the wireline margin stays pretty much the same. So, there really should not be dilution when we closed this transaction, it should all be offset through cost measures.

Simon Flannery - *Morgan Stanley - Analyst*

Okay, great. And on the balance sheet, obviously there's been some leverage coming on with the auction and you sold some assets, but how are you thinking about returning to your target leverage metrics? And we've obviously seen a buyback here which was money that you could have used to delever, but you decided you had enough visibility to buy back at this point.

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

I mean just to give us a sense of how we thought about this, we divested $15 billion worth of assets and we felt it was only fair to return a piece of that back to the shareholder for shareholder value, which led us to the accelerated repurchase program. And by taking the rest of the proceeds and obviously paying off the debt that we raised with the spectrum, which we said we were going to have to buy spectrum which the rating agencies knew, everybody knew we were going to have to buy spectrum, we built up $8 billion on the balance sheet. We will repay the majority of the term loan that we took to buy the auction with the proceeds of the towers and then when we get the rest of the proceeds from the Frontier transaction, all those proceeds will be used to pay down debt. So it puts us right on track with the commitment that Lowell and I made the day we closed Vodafone which said by the year 2017-2018, we will be back to an A minus rated company within that four to five years, 2018 and 2019. So, we'll be back to that A minus company and we are right on track to deliver on that.

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Simon Flannery - *Morgan Stanley - Analyst*

Good. So in terms of some of the growth assets, you've provided some good financial disclosure on Internet of Things so thank you for that. Help us with the over-the-top mobile-first video. How should we think about this the impact in 2015, the impact in 2016? There's a lot of different offerings coming out from various folks. How should we think about your financial impact?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Well, as I said, we've been working on this for a number of years with the accumulation of assets we have and we believe that we have accumulated the number of assets with Verizon Digital Media Services, EdgeCast, upLynk, and OnCue to be able to deliver a very viable product that can do a lot of things. Marni Walden, who is leading this effort up, we will disclose more of that as we get closer to our launch in the summer. But the combination of both, if you think about the multicast technology that we launched, the network's ready to go. The multicast technology is very efficient to deliver a very large event to millions of customers at the same time like a Super Bowl, like a concert, which is very efficient to do. So that will be a component of this, but it will be a lot more than that. And without divulging too much, I'll leave it at that, but there will be a lot more to discuss as we get closer to launch.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. I referenced earlier the FCC vote last week on net neutrality and Title II. You put out some amusing press releases in Morse code. Can you just talk about what you understand today? Have you had any more color into the exact content? I know we got to wait a few weeks before we get the full order and how you're going to respond to that?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

So, I mean just so everybody understands. The FCC voted three, two to pass Title II regulation and net neutrality. We don't actually know what it is yet, it's over a 300-page order that has not been shown to anyone yet. We'll get that within the next couple of weeks. So, it's probably a little bit premature to determine what the impact of that is and what does that all mean. But I guess the way I could put it plainly is as we sat here yesterday and we looked out in front of us, we had an open field to invest, innovate, deliver products to the consumer, and really drive growth and benefits to the consumer.

Now that field has been cluttered up with a lot of obstacles so it's going to be more difficult to invest, it's going to more difficult to innovate, and deliver speedy solutions to the consumer because now you're going to have to navigate what is regulated, what isn't regulated, and all this other stuff. So I think we'll have to wait to see, but I'm pretty much assured that it will have an impact on investment and innovation over the longer term just like we've seen what happened in Europe and other places. So without any more comment around that, we'll have to wait and see what happens; but you could probably take an assumption that there's going to be a lot of litigation around this when it's all said and done.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. Can you talk about the cash tax position? How you're thinking about that? With that bonus depreciation extended for another year, the tax reform is being kicked around although there hasn't been a whole lot of progress so far? How's that going to impact Verizon in 2015 and 2016?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

It's a shame we can't get to a standard tax reform mechanism to make sure that everybody can plan into the future because it makes it very difficult when you turn bonus depreciation on and you turn it off and you're not sure when it's coming, when it's not coming so it does make it a little difficult to plan. But if you look back at 2014, our federal income cash tax went to $4.1 billion. Now if you look back to 2013, that was $400 million

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so that was a significant cash increase on that. Now a lot of that had to do with the Vodafone transaction which we said when we bought if you step back, we used to distribute about $5 billion to $6 billion a year to Vodafone under a tax distribution clause.

We're now just taking the distribution we used to do to Vodafone and actually distributing that to the federal government in a cash tax. So, we said cash tax would go up. It will continue to go up as profits in Verizon Wireless go up and so you should anticipate an increase in 2015. Now we were anticipating a lot larger increase, but we did get a tiny benefit from bonus depreciation, but right now that all reverses out in 2016. So you have to take that, I'm not going to disclose exact numbers here because it's very hard to determine what the impact of that was, but there was a benefit and then that will reverse in 2016 if we don't get the extension on that. So I'll leave it at that, but our cash taxes will increase in 2015 over 2014.

Simon Flannery - *Morgan Stanley - Analyst*

Feels a little bit like we're going to be running to the end of the year to find out what the tax rate is again?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Well, tax rate's one thing, cash tax is the second.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. We've got time for a couple of questions. If you'll wait for a mic here. We've got a question in the front here.

QUESTIONS AND ANSWERS

Unidentified Audience Member

Given the stretched balance sheets of some of your smaller competitors were making noise in the marketplace, I mean at what point do you think the competitive intensity starts to reverse as in it gets much better for you compared to what it was in Q4?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

I mean I can't answer for what they will do and what they won't do and I won't speak to their balance sheets. I've been pretty much on record saying at the end of the day in this industry you need to be free cash flow positive because as your customer base uses your network more and more, you need to build and reinvest in capacity, and densification, and coverage; and that's the equation that's works in this business. So at some point, you have to generate cash, you have to redeploy that cash back into your network. So, I think that at the end of the day we have a record of doing that. We have a record of competing in this environment. I mean if you look at 2014, we actually grew more in 2014 than we did in 2013.

Now you could argue a lot of that growth came from more tablets, but I said coming into 2013, tablets was going to be a growth for the industry for the next three to five years. And again, the net phone category, it's not going to be as important because a lot of the growth is going to come from other things that don't end up in net adds. So I think that at least where we are, we're focused on moving the Company forward in other things like Internet of Things and over-the-top mobile video that other companies aren't even investing in at this point in time. So to me, it's a differentiation going forward in giving your customer more value and at the end of the day that's what will win in the marketplace.

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Unidentified Audience Member

One on the wireless side, Google has confirmed they are going to come out with something and how do you feel they're going to affect the market both in terms of pricing, but more importantly in terms of range or breadth of services? And then FiOS, I know you're densifying, you're getting some places where you're eliminating most of the copper; where do you really start to see the OpEx synergies on the assets that were promised a while ago?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

On Google, I know what their announcement was, but they also made a lot of disclosures around that announcement that this is for them to innovate certain things on their platforms, bring more innovation to the market. They obviously disclosed in the fourth quarter they started an MVNO with T-Mobile and Sprint. And look, I mean I think we're just going to have to sit and wait and see what happens with that, but I'm not real concerned at this point about that. One will have to see how they execute on that and see how the market responds to that and then we'll act accordingly. As far as FiOS goes, you're already starting to see some of these expense benefits come through just based on increasing margin from 2013 to 2014, which is what we committed to, and increasing that margin again from 2014 to 2015. So there's a whole lot of things that go behind that, but the more copper we can eliminate and put onto fiber within the FiOS buildout footprint, obviously we get an immediate benefit from a repair and maintenance standpoint. So from that perspective, you're already starting to see some of that benefit with the 80 basis point margin increase year-over-year that we demonstrated in 2014.

Unidentified Audience Member

How do you feel about the sort of future competitive threat I guess from people like Comcast putting together a WiFi network that might be using telephony and I guess the future of sort of those mesh networks?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Well, look I mean when we did a deal with Comcast to buy the spectrum, we entered into an MVNO with them and they can execute on that MVNO any time they want. And as Lowell has said before, we'd do that agreement again and the price of the spectrum was a good deal for us and the MVNO was a good deal for them. We'll to wait to see how they execute on that. I mean if you look at it, we look at WiFi as a complementary technology with LTE and if you look at the growth of the networks, WiFi and LTE go up in a parallel range. Today 80% of usage is occurring on WiFi, but I'm still gaining revenue share, I'm growing at over 5%. I mean last year we grew at about 7% in wireless on a base of $80 billion. So obviously people really enjoy using the LTE network because it works extremely well, it provides a quality of service that WiFi can't provide, and it's a consistent experience which WiFi can't provide.

So look again, I think it's a complementary technology. I mean if you want to take this even further and look at unlicensed LTE, which is very similar to WiFi. I mean Tony talked about this on the spectrum call; we're starting to look at that technology, we can launch that technology, and be very efficient with that technology. So look, I think we'll wait and see what happens, but an MVNO is easier to start in words than it is actually on execution so we'll have to wait to see.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. Question in the back.

Unidentified Audience Member

You guys have already rolled out voice over LTE in a couple of markets and in a couple of phones. What's been the feedback from customers about that offering and is the plan still to extend it to the rest of the nation?

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Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Well, we actually did launch nationwide. The customer itself can opt in anytime they want so whatever phone you have, you can go into that 4G LTE phone if you bought it in the fourth quarter of this past year and you can go in and opt in what we call VoLTE or Advanced Calling 1.0 and you can opt into that and the network works. The only thing is it will not be backwards compatible with CDMA. But the VoLTE network that we launched is a nationwide coverage, it's working extremely well, we've gotten very good feedback, obviously it's very slow to progress. But if you look at our progression, obviously we want more people to get on to the VoLTE network which is LTE and the reason for that is it frees up capacity in the CDMA network, which then we can start to take five by five slivers of spectrum and redeploy over to the LTE network. So, that's part of the capacity strategy. But it's the customer's option whether they want to go or not.

Simon Flannery - *Morgan Stanley - Analyst*

And you still have something like 47 megahertz dedicated to CDMA?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

That's correct.

Simon Flannery - *Morgan Stanley - Analyst*

Maybe one last one, Fran. Talking about your video strategy, how do you think about content and content rights and the need to own content? You did a deal with the NFL a little while ago so what's the role of the telco in terms of relation to content?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Well, I think at this point, I mean our underlying philosophy hasn't changed. We don't need to own large pieces of content to be successful in the ecosystem. Now what Marni is working on is something a little different than that and again, I'll wait till the summer launch when we can talk a lot more about that. But there's going to be very different models in the over-the-top mobile video than there was in the linear TV model. You can't make money paying $5 a sub for every sub you have. With 103 million subs, it doesn't make economic sense and the content providers know that. So, you're going to see very different models come out in this ecosystem and we'll wait to disclose more of that when we launch, but it won't be a linear TV model.

Simon Flannery - *Morgan Stanley - Analyst*

Okay. Did the NFL deals help in terms of driving loyalty and viewership and so forth?

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

The NFL deal along with IndyCar deal has given us some insights into how people consume this content. And if you look at it, the average consumer views a video on their mobile handset average is 30 minutes, which is longer than you would think it is, but they're in short clips so you're not going to watch a linear TV program here. The NFL has been a great partner. It's been a huge success during the NFL season and we saw a lot of growth in our usage during that similar to what we saw in the World Cup. So, we're learning a lot about usage patterns in this that we will adopt in the over-the-top model.

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Simon Flannery - *Morgan Stanley - Analyst*

Great. Well, thank you, Fran. We appreciate your time.

Fran Shammo - *Verizon Communications Inc. - EVP & CFO*

Thank you, Simon. Thank you, everyone.

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