

Equity Research

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Price Target Change — July 24, 2022

Wireless Carriers

Verizon Communications Inc. (VZ)

VZ: Big Red Is Feeling the Inflationary Burn in Challenging Q2

Our Call

VZ had a challenging Q2 print, with consumer phone subs weakening more than we expected and the outlook for profitability deteriorating. VZ finds itself in a precarious position in the consumer wireless space—raising prices across its base despite being the premium-priced provider, yet also trying to attack the value segment with its prepaid brand and a new "slimmed down" unlimited offering. We're also not seeing any boost to profitability despite lower consumer volumes, as VZ has been incurring heavy promotional spend despite the weaker subscriber adds. The result is a ~3% cut to FY'22 EBITDA guide and ~5% cut to earnings, which also likely imperils VZ's multi-year revenue guide. We're cautiously optimistic we won't see further downside revisions to estimates after this quarter, but we also struggle to see meaningful upside potential if subscriber adds and margins remain weak throughout the year. We're lowering our PT to \$48 and remain at Equal Weight.

Tale of Two Cities with Business / Consumer Wireless - In its consumer channel, VZ lost 215K postpaid phone customers relative to our expectation for -60K net losses. VZ felt pressure on both gross adds (-11% yr/yr) and churn (+10 bps yr/yr), with the expiration of consumer stimulus funding called out as one culprit. VZ started to phase in its additional fee increases in June, which could create some incremental churn in 2H'22 (with VZ calling out a "bubble" of churn potentially in Q3). It's attempting to broaden its value offerings with a new lower-end unlimited plan (as low as \$30/line for a family of 4), which will come at lower ARPU's but also with fewer upfront costs (i.e., no device promotions). The business channel has been performing quite well, delivering +227K phone adds and management suggesting strength should continue in 2H'22. But the more muted consumer volumes, along with the ARPA impact from device promotions, moved its wireless service revenue guide down by 50 bps for FY'22.

FWA Remains a Bright Spot, Even with Softer FiOS Adds - VZ delivered +256K fixed wireless (FWA) net adds, ahead of our +230K expectation, and cited improving subscriber performance each month of '22-to-date. We now expect over 1MM net adds across its business and consumer channels in FWA for FY'22, which will provide a tailwind to service revenues this year and next. FiOS net adds were only +36K, the lowest number in 8 quarters (and down from 99K yr/yr), with lower move churn and weaker gross adds contributing (despite embedded churn remaining very low).

Business Wireline Under Pressure - Similar to what we heard from AT&T yesterday, VZ's business wireline revenue results were weak, with business revenues (excluding wireless + FiOS) down ~11% yr/yr (exacerbated by lower USF rates and foreign currency headwinds). We would expect the pressure on legacy voice and copper-based products to remain through the balance of the year, with business wireline continuing to soften at a low-double-digit clip through the remainder of 2022.

Lowering PT to \$48; Remain at Equal Weight - VZ still trades at a slight NTM EBITDA and P/E premium to its closest comparable T, which just posted a more encouraging quarter from a subscriber growth perspective. While we still believe some of VZ's pricing actions should improve the outlook in 2023, a high degree of uncertainty and execution risk remains as they adjust wireless offerings to try to stimulate subscriber growth. We've trimmed our DCF-based PT to \$48 on a weaker FCF outlook, assuming a 7x terminal

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Rating	Equal Weight
Ticker	VZ
Price Target/Prior:	\$48.00/\$52.00
Upside/(Downside) to Target	8.0%
Price (07/22/2022)	\$44.45
52 Week Range	\$45.55 - 56.34
Shares Outstanding	4,199,643,701
Market Cap (MM)	\$186,674
Enterprise Value (MM)	\$315,171
Average Daily Volume	23,157,810
Average Daily Value (MM)	\$1,029
Dividend (NTM)	\$2.56
Dividend Yield	5.8%
Net Debt (MM) - last reported	\$141,039
ROIC - Current year est.	14%
3 Yr EPS CAGR from current year (unless otherwise noted)	3%

\$	2021A	2022E	2022E	2023E	2023E
EPS		Curr.	Prior	Curr.	Prior
Q1 (Mar)	1.31 A	1.35 A	NC	1.35 E	1.39 E
Q2 (Jun)	1.37 A	1.31 A	1.32 E	1.35 E	1.41 E
Q3 (Sep)	1.41 A	1.28 E	1.39 E	1.36 E	1.43 E
Q4 (Dec)	1.31 A	1.25 E	1.37 E	1.30 E	1.39 E
FY	5.40 A	5.19 E	5.43 E	5.35 E	5.61 E
P/E	8.2x	8.6x		8.3x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, Volatility = Historical trading volatility

value multiple and 8% WACC. Our new FY'22/23 EPS estimates are \$5.19 / \$5.35 (vs. \$5.43 / \$5.61 prior).

SUMMARY OF ESTIMATES

(\$ in millions)

	Q2'22A	Q2'22E	Q2'21A	Yr/Yr Change
Consumer Wireless Service	15,236	15,221	13,794	10.5%
Business Wireless Service	3,182	3,171	3,090	3.0%
Wireless Service Revenue	18,418	18,392	16,884	9.1%
Consumer Revenue	25,604	25,513	23,477	9.1%
Business Revenue	7,626	7,549	7,762	-1.8%
Consolidated Revenues	33,789	33,537	33,764	0.1%
Consumer EBITDA	10,361	10,599	10,397	-0.3%
Business EBITDA	1,749	1,740	1,871	-6.5%
Consolidated Adjusted EBITDA	11,873	12,090	12,185	-2.6%
Adjusted EPS	\$1.31	\$1.32	\$1.37	-4.4%
Consumer EBITDA Margin	40.5%	41.5%	44.3%	-382 bps
Business EBITDA Margin	22.9%	23.1%	24.1%	-117 bps
Consolidated Adjusted EBITDA Margin	35.1%	36.0%	36.1%	-95 bps
Operating Margin	23.3%	23.8%	24.8%	-159 bps
Operational Statistics				
Total Net Additions	285	315	546	-47.8%
Postpaid Net Additions	514	390	528	-2.7%
Consumer	84	125	350	-76.0%
Business	430	265	178	141.6%
Postpaid Phone Net Additions	12	100	275	-95.6%
Consumer	(215)	(60)	197	-209.1%
Business	227	160	78	191.0%
Prepaid Net Additions (Consumer)	(229)	(75)	18	-107.9%
Postpaid Churn	1.03%	1.07%	0.94%	9 bps
Consumer	0.93%	1.00%	0.83%	10 bps
Business	1.37%	1.30%	1.30%	7 bps
Consumer Postpaid ARPA	\$124.16	\$124.39	\$121.24	2.4%
Total FiOS Internet Net Additions	36	70	99	-63.6%
Total FiOS Video Net Additions	(87)	(59)	(63)	-27.6%

Source: Wells Fargo Securities, LLC Estimates and Company Reports

SUMMARY OF ESTIMATES

(\$ in millions)

	Q3'22E		FY'22E		FY'23E	
	NEW	OLD	NEW	OLD	NEW	OLD
Consumer Wireless Service	15,590	15,697	61,738	61,903	63,063	63,710
Business Wireless Service	3,224	3,200	12,798	12,744	13,351	13,234
Wireless Service Revenue	18,814	18,897	74,535	74,647	76,414	76,943
Consumer Revenue	25,721	25,978	104,035	103,980	106,439	107,474
Business Revenue	7,547	7,510	30,508	30,406	30,104	30,476
Consolidated Revenues	33,768	33,988	136,681	136,439	138,688	140,095
Consumer EBITDA	10,520	10,949	41,836	42,838	43,496	44,804
Business EBITDA	1,718	1,787	6,880	7,062	6,895	7,160
Consolidated Adjusted EBITDA	12,033	12,516	47,909	49,043	49,594	50,833
Adjusted EPS	\$1.28	\$1.39	\$5.19	\$5.43	\$5.35	\$5.61
Consumer EBITDA Margin	40.9%	42.1%	40.2%	41.2%	40.9%	41.7%
Business EBITDA Margin	22.8%	23.8%	22.5%	23.2%	22.9%	23.5%
Consolidated Adjusted EBITDA Margin	35.6%	36.8%	35.1%	35.9%	35.8%	36.3%
Operating Margin	23.2%	24.7%	22.8%	23.8%	23.3%	24.1%
Operational Statistics						
Total Net Additions	535	395	1,744	1,464	2,045	2,110
Postpaid Net Additions	635	465	2,218	1,754	2,025	2,090
Consumer	255	240	633	634	905	705
Business	380	225	1,585	1,120	1,120	1,385
Postpaid Phone Net Additions	75	170	346	454	175	175
Consumer	(125)	50	(537)	(207)	(215)	(215)
Business	200	120	883	661	390	390
Prepaid Net Additions (Consumer)	(100)	(70)	(474)	(290)	20	20
Postpaid Churn	1.06%	1.07%	1.05%	1.06%	1.07%	1.07%
Consumer	0.97%	1.00%	0.96%	0.99%	1.00%	1.00%
Business	1.35%	1.28%	1.32%	1.28%	1.30%	1.30%
Consumer Postpaid ARPA	\$128.58	\$129.44	\$126.43	\$127.01	\$130.46	\$131.05
Total FiOS Internet Net Additions	80	80	251	285	340	340
Total FiOS Video Net Additions	(59)	(59)	(282)	(254)	(136)	(136)

Source: Wells Fargo Securities, LLC Estimates and Company Reports

Financials

VZ Income Statement

Verizon Communications Inc.

Dollars in millions except per share amounts and subscriber data in '000s

Income Statement		2018	2019	2020	Q1	Q2	Q3	Q4	2021	Q1	Q2	Q3E	Q4E	2022E	2023E	2024E	2025E
Consumer		89,762	91,056	88,533	22,798	23,477	23,328	25,697	95,300	25,292	25,604	25,721	27,418	104,035	106,439	108,191	109,287
	yly growth %		1.4%	-2.8%	4.7%	11.2%	7.3%	7.4%	7.6%	10.9%	9.1%	10.3%	6.7%	9.2%	2.3%	1.6%	1.0%
Business		31,534	31,443	30,975	7,781	7,762	7,689	7,810	31,042	7,709	7,626	7,547	7,627	30,508	30,104	30,635	30,914
	yly growth %		-0.3%	-1.5%	1.2%	3.7%	-0.8%	-3.0%	0.2%	-0.9%	-1.8%	-1.9%	-2.3%	-1.7%	-1.3%	1.8%	0.9%
Total Other		9,567	9,369	8,784	2,288	2,525	1,898	560	7,271	553	559	500	525	2,137	2,145	2,145	2,145
	seq. growth %				-3.3%	-0.2%	-0.9%	1.6%	-1.3%	-1.1%	-1.0%	1.1%					
Total Operating Revenues		130,863	131,868	128,292	32,867	33,764	32,915	34,067	133,613	33,554	33,789	33,768	35,570	136,681	138,688	140,971	142,345
Cost of services		32,185	31,772	31,401					31,234	7,227	6,932	7,064	7,136	28,359	28,900	29,360	29,399
	yly growth %		0.8%	-2.7%	4.0%	10.9%	4.3%	-1.8%	4.1%	2.1%	0.1%	2.6%	4.4%	2.3%	1.5%	1.6%	1.0%
Cost of wireless equipment		23,323	22,952	19,800	5,502	5,931	5,673	7,961	25,067	7,123	7,488	7,242	8,922	30,775	31,311	31,554	31,496
	seq. growth %				-5.3%	2.7%	-2.5%	3.5%	-1.5%	0.7%	-0.1%	5.3%		20.7%	20.8%	20.8%	20.7%
Total cost of sales and services		55,508	54,724	51,201	13,522	14,255	13,528	14,996	56,301	14,350	14,420	14,306	16,058	59,135	60,211	60,914	60,895
	% of revenue	24.6%	24.1%	24.5%	24.4%	24.7%	23.9%	20.7%	23.4%	21.5%	20.5%	20.9%	20.1%	20.7%	20.8%	20.8%	20.7%
Selling, general & administrative expense		31,083	29,896	31,573	7,401	7,324	6,521	7,412	28,658	7,172	7,496	7,429	7,541	29,638	28,883	29,022	28,931
	SG&A % of revenue	23.8%	22.7%	24.6%	22.5%	21.7%	19.8%	21.8%	21.4%	21.4%	22.2%	22.0%	21.2%	21.7%	20.8%	20.6%	20.3%
Adjusted EBITDA		47,410	47,191	47,060	12,167	12,185	12,263	13,638	50,253	12,032	11,873	12,033	11,971	47,909	49,594	51,035	52,519
Depreciation & Amortization		17,403	16,682	16,720	4,174	4,020	3,961	4,051	16,206	4,236	4,321	4,390	4,428	17,375	17,953	18,074	18,110
	D&A % of revenue	13.3%	12.7%	13.0%	12.7%	11.9%	12.0%	11.9%	12.1%	12.6%	12.8%	13.0%	12.5%	12.7%	12.9%	12.8%	12.7%
Adjusted Operating Income		28,855	34,289	31,648	7,993	8,390	8,446	7,714	32,543	7,796	7,558	7,638	7,728	31,220	32,341	33,561	34,909
Equity in earnings of unconsolidated businesses		(196)	(15)	(45)	8	1	1	135	145	(3)	41	5	5	48	20	20	20
	Adjusted Operating Margin %	22.0%	26.0%	24.7%	24.3%	24.8%	25.7%	22.6%	24.4%	23.2%	22.3%	22.3%	21.7%	22.8%	23.3%	23.8%	24.5%
Other income (expense), net		2,364	(2,900)	(539)	401	502	269	(860)	312	(924)	49	175	175	(525)	1,200	1,200	1,200
	Interest expense	(4,833)	(4,730)	(4,247)	(1,101)	(844)	(801)	(739)	(3,485)	(786)	(785)	(921)	(932)	(3,424)	(3,833)	(4,735)	(4,972)
Minority interest																	
Adjusted pre-tax income		26,200	26,644	26,817	7,301	8,049	7,915	8,123	31,388	6,083	7,163	7,097	6,976	27,319	29,728	30,446	31,157
GAAP pre-tax income		19,623	22,735	23,967	7,078	7,824	8,374	8,017	31,293	6,083	6,857	6,902	6,791	26,633	29,028	29,446	30,657
Income tax adjustment		(6,331)	(6,199)	(6,377)	(1,756)	(1,829)	(1,913)	(1,738)	(7,236)	(1,372)	(1,542)	(1,604)	(1,576)	(6,093)	(6,722)	(6,796)	(7,167)
	Effective tax rate %	24.6%	23.7%	23.8%	24.5%	23.2%	24.6%	21.7%	23.1%	23.1%	21.9%	23.0%	23.0%	24.0%	24.0%	24.0%	24.0%
GAAP (provision) benefit for income taxes		(3,584)	(2,945)	(5,619)	(1,700)	(1,875)	(1,820)	(1,407)	(6,802)	(1,372)	(1,542)	(1,559)	(1,533)	(6,006)	(6,561)	(6,766)	(7,050)
GAAP net income (consolidated)		16,039	19,790	18,348	5,378	5,949	6,554	6,610	24,491	4,711	5,315	5,344	5,258	20,627	22,466	22,680	23,607
Net income attributable to noncontrolling interest		(511)	(523)	(547)	(133)	(149)	(147)	(124)	(553)	(131)	(116)	(125)	(125)	(497)	(500)	(500)	(500)
Income from discontinued ops, net of tax																	
Adjusted Net Income (attributable to Verizon)		19,358	19,922	19,893	5,412	6,071	5,855	6,261	23,599	4,580	5,505	5,369	5,275	20,728	22,505	22,750	23,490
GAAP Net Income (attributable to Verizon)		15,528	19,267	17,801	5,245	5,800	6,407	6,486	23,938	4,580	5,199	5,219	5,133	20,130	21,966	22,180	23,107
Reported Diluted EPS		\$ 3.77	\$ 4.65	\$ 4.30	\$ 1.27	\$ 1.40	\$ 1.55	\$ 1.56	\$ 5.77	\$ 1.09	\$ 1.24	\$ 1.24	\$ 1.22	\$ 4.79	\$ 5.22	\$ 5.27	\$ 5.49
Total EPS Adjustments					\$ 0.04	\$ (0.03)	\$ (0.14)	\$ (0.25)		\$ 0.26	\$ 0.07	\$ 0.04	\$ 0.03				
Adjusted Diluted EPS		\$ 4.71	\$ 4.81	\$ 4.90	\$ 1.31	\$ 1.37	\$ 1.41	\$ 1.31	\$ 5.40	\$ 1.35	\$ 1.31	\$ 1.28	\$ 1.25	\$ 5.19	\$ 5.35	\$ 5.41	\$ 5.58
Diluted shares			2.3%	1.9%	4.0%	15.6%	12.8%	8.3%	10.1%	3.1%	-4.4%	-9.4%	-4.2%	-3.8%	3.1%	1.1%	3.3%
	yly growth %				4.142	4.141	4.144	4.169	4.202	4.202	4.202	4.203	4.204				
Dividend per share		\$ 2.39	\$ 2.44	\$ 2.49	\$ 0.63	\$ 0.63	\$ 0.64	\$ 0.64	\$ 2.54	\$ 0.64	\$ 0.64	\$ 0.64	\$ 0.64	\$ 2.56	\$ 2.64	\$ 2.76	\$ 2.84

Source: Wells Fargo Securities, LLC Estimates and Company Reports

Source: Company reports and Wells Fargo Securities, LLC estimates

Investment Thesis, Valuation and Risks

Verizon Communications Inc. (VZ)

Investment Thesis

We believe VZ can continue to be a market leader with the transition to 5G based on its industry-leading 4G network, but ultimately believe it will continue to lose subscriber share given its premium-priced offerings, which leaves us at Equal Weight on the shares.

Target Price Valuation for VZ: \$48.00 from \$52.00

Our \$48 price target is based on a 7-year DCF with a WACC of 8% and a terminal value EBITDA multiple of ~7x, which is a modest discount to VZ's historical +7.5x EBITDA multiple.

Risks to Our Price Target and Rating for VZ

Downside risks to our price target include lack of mid-band spectrum assets vs. peers, limited visibility into 5G growth adjacencies and regulatory risks from a new administration. Upside risks include faster-than-anticipated roll-out of its premium Ultra Wideband 5G network; market share gains in the competitive wireless sector; and margin expansion from cost-cutting initiatives.

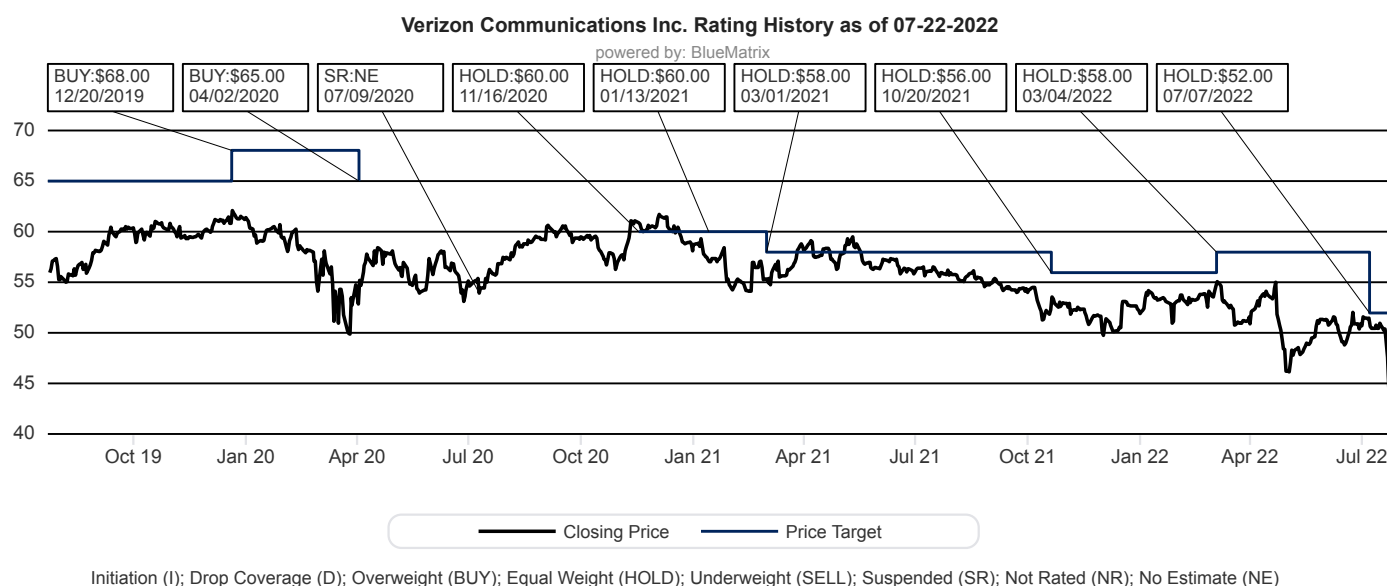
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3=Underweight: Total return on stock expected to lag the Overweight- and Equal Weight-rated stocks within the analyst's coverage universe over the next 12 months. SELL

As of July 23, 2022

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