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# EDITED TRANSCRIPT

VZ - Q4 2016 Verizon Communications Inc Earnings Call

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## OVERVIEW:

Co. reported 4Q16 operating revenues of \$32.3b and GAAP EPS of \$1.10.



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## CORPORATE PARTICIPANTS

**Michael Stefanski** *Verizon Communications Inc. - SVP, IR*

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

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**Phil Cusick** *JPMorgan - Analyst*

**John Hodulik** *UBS - Analyst*

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**Mike Rollins** *Citigroup - Analyst*

**Brett Feldman** *Goldman Sachs - Analyst*

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**Amir Rozwadowski** *Barclays Capital - Analyst*

## PRESENTATION

## Operator

Good morning and welcome to the Verizon fourth-quarter 2016 earnings conference call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

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

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**Michael Stefanski** - *Verizon Communications Inc. - SVP, IR*

Thanks, Tori. Good morning and welcome to our fourth-quarter earnings conference call. This is Mike Stefanski and I am here with our Executive Vice President and Chief Financial Officer, Matt Ellis.

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

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

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

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

Before Matt goes through our results, I would like to highlight a few items. For the fourth quarter of 2016, we reported earnings of \$1.10 per share and full-year earnings of \$3.21 per share on a GAAP basis. These reported results include a few nonoperational items that I would like to highlight.



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Our reported fourth-quarter earnings include a non-cash, pretax gain of about \$1.6 billion. The largest item was the mark-to-market adjustment of our pension and OPEB liabilities, which was a pretax gain of roughly \$1.8 billion. This adjustment, which was primarily non-cash, was caused by an increase in the discount rate as well as other planned factors.

We also incurred pretax expenses of nearly \$200 million, primarily related to severance costs under our existing separation plans. The net impact of these items after tax approximated \$1 billion, or \$0.24 per share.

Excluding the effect of these nonoperational items, adjusted earnings per share were \$0.86 in the fourth quarter compared to \$0.89 a year ago, a decline of 3.4%. For the full year, adjusted earnings per share were \$3.87 compared with \$3.99 in 2015, a decrease of 3%. Recall that our 2015 adjusted EPS included \$0.13 of depreciation benefit related to the three Wireline properties that we sold to Frontier.

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

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

Thanks, Mike. Good morning to everyone on the call and thank you for joining us today. I look forward to working with our investors and all of you who follow our stock in sharing progress on our strategy to deliver the promise of the digital world.

We are in a vibrant and exciting industry. Our leadership position in wireless and fiber networks, as well as our loyal and high-quality customer base, is a reflection of our commitment to continuous improvement by our outstanding employees, which places us in a great position for long-term profitable growth. The continuous changes from technology advances and the competitive environment will provide us new opportunities to evolve and develop innovative solutions to continue to be a key player in this dynamic market.

I am energized by those challenges and the great team we have and I am excited about the coming years. My primary objective is to build on the strong foundation of this business and ensure we are always being responsible stewards of the Company by running the business as we have today as efficiently and effectively as possible, while investing responsibly to deliver long-term growth and shareholder value.

Let's now move into an overview of 2016.

As expected, 2016 was a transformative year for Verizon. We demonstrated strong financial performance and returned value to our shareholders while repositioning the business. Our core businesses are executing well in highly competitive markets and we are on track with our strategic priorities.

During 2016 we completed Wireline divestitures of three markets, negotiated new contracts with our labor unions, executed successful 5G technical trials, and gained traction in new growth businesses. Operationally, in Wireless, with our network leadership strategy, we added 1.3 million smartphone net adds and maintained industry-leading retail phone churn performance of less than 0.9% for the year after seven consecutive quarters.

In Wireline, we restructured the segment and its cost structure. Overall, we delivered solid operational and financial results, which I will go into more detail in a few minutes.

Our capital allocation was consistent with our strategy. We invested in adding capacity through densification of the 4G network, acquired telematics and smart city businesses, and extended ecosystems to monetize data traffic. We reduced our unsecured debt and delivered strong value to our shareholders through the 10th consecutive increase in annualized dividends last September.

Entering 2017 we are confident with our strategy and priorities to serve customers and increase value. The foundation of our strategy is a network that is ubiquitous and reliable. We will continue to invest in our networks, expand network capabilities, and advance ecosystems to offer value to our customers.



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The execution of these priorities will allow us to lead at the network layer and develop innovative solutions to meet customer demands in the rapidly expanding mobile-first digital world.

Now let's get right into the operating performance, starting with our consolidated results on slide 6.

Total operating revenue in the fourth quarter was \$32.3 billion, a decline of 5.6%. Consolidated 2016 revenue was \$126.0 billion, representing a decline of 4.3%. If we exclude revenues from the divested Wireline properties and AOL, which became part of our operations during the second half of 2015, adjusted operating revenue would have declined approximately 2.4%.

Wireless revenue tracked with our expectations in the quarter as the shift from service revenue to equipment revenue across our base of customers is ongoing. Equipment revenue was seasonally strong, primarily led by new smartphone launches and equipment installment take rates. Wireline segment revenues continued recent trends, declining 3.1% with consumer growth of 0.2% for the quarter.

In our new businesses we are pleased with AOL's performance for the quarter and full year. In the fourth quarter, our digital media business, led by AOL, generated revenue of \$532 million net of traffic acquisition costs. This revenue is down about 5% year over year as expected, due to the revenue lift related to the Microsoft deal in the fourth quarter of 2015, but increased around 10% sequentially, in line with expectations.

Organically, Internet of Things revenue was \$243 million, up 21% in the fourth quarter. We expect to sustain these strong trends. Including acquisitions, Internet of Things revenue increased more than 60% in the fourth quarter.

Strong cost management across the business enabled us to drive profitability, including offsetting the lost earnings contribution from the divested Wireline markets. On a consolidated full-year basis, excluding nonoperational items, EBITDA totaled \$44.8 billion and EBITDA margin was 35.5%.

Now let's turn to cash flows and the balance sheet on slide 7.

In 2016, cash flows from operations totaled \$22.7 billion, which is impacted by payments of cash income taxes of \$3.2 billion associated with the gain on the divested wireline properties. Full-year capital spending of \$17.1 billion was just below our guidance of \$17.2 billion to \$17.7 billion. Free cash flow for the year totaled \$5.7 billion, which does not include the proceeds from on-balance-sheet securitization transactions.

In the second half of 2016, we shifted to on-balance-sheet securitization of our equipment receivables as it provides us a lower overall cost of funding. As we have previously noted, the proceeds from our on-balance-sheet securitization program are reflected in the cash flows and financing. During the fourth quarter, we generated cash proceeds of about \$2.4 billion from on-balance-sheet securitization, for a total of \$5.0 billion during the second half of the year.

Our balance sheet is strong and provides us with financial flexibility to grow the business. We ended the year with \$108.1 billion of gross debt, which comprised of \$103.1 billion of unsecured debt and \$5 billion of on-balance-sheet securitizations. Our year-end unsecured debt balance was lower by \$6.6 billion from the prior year. We remain on track to return to our pre-Vodafone credit-rating profile by the 2018 to 2019 timeframe.

Now let's move into a review of the segments starting with Wireless on slide 8.

In the Wireless business, we are delivering a balanced operational performance in a highly-competitive environment. Total Wireless operating revenue declined 1.5% in the quarter to \$23.4 billion. For the full year, operating revenue totaled \$89.2 billion, a decline of 2.7%.

Service revenue of \$16.3 billion declined 4.9% for the quarter as compared to the 5.2% decline in the third quarter. For the full year, service revenue declined 5.4%.

Overall, service revenue trends are consistent with the postpaid base migrations to unsubsidized service pricing. Approximately 67% of our postpaid customers are now on unsubsidized pricing, which is ahead of our expectations, due to higher volumes in the fourth quarter.



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Service revenue plus device payment plan billings increased 1.7% in the fourth quarter and 2.0% for the full year. This deceleration in trend is due to the strong migration of customers in the second half of the year to unsubsidized pricing as customers fulfilled their prior service contracts.

We are also seeing strong migrations to our new pricing structure that we launched midyear with safety mode and carryover data. While these plans have resulted in greater-than-expected optimization, they improved customer satisfaction and retention. Recently we launched a single-line pricing plan to improve our competitive position in that segment.

Equipment revenue increased to \$5.7 billion, up 6.2% for the fourth quarter and 3.5% for the full year. The percentage of phone activations on device payment plans increased to approximately 77% in the fourth quarter, compared with about 70% in the third quarter and about 67% in the fourth quarter of 2015.

We expect the first-quarter take rate for device payment plans to be similar to 4Q as two-year service contracts are no longer available for upgrades by the embedded base. At the end of the quarter, approximately 46% of our postpaid phone customers had a device payment plan.

Improving the cost structure of our Wireless segment is a priority. We see additional opportunities to increase efficiencies in our operating model through the continued application of our Verizon Lean Six Sigma processes.

On total revenues, our EBITDA wireless margin was 36.9% for the fourth quarter and 43.8% for the year. In terms of profitability, we generated \$8.6 billion of EBITDA in the quarter, a decrease of 5.2%. For the full year, total EBITDA was \$39.0 billion, an increase of 0.2%.

As expected, the equipment promotional activity in the quarter was elevated given the holiday season. We will remain competitive in the marketplace.

In the fourth quarter, overall traffic on LTE increased by approximately 49%, while we extended our lead in the industry's third-party performance studies across the country. Wireless capital spending totaled \$3.5 billion in the quarter and \$11.2 billion for the full year.

Now let's turn to slide 9 and take a closer look at Wireless connections growth.

In the fourth quarter, we added high-quality retail postpaid net additions of 591,000 with a sequential improvement in the number of 4G smartphone and total phone net adds. We added 552,000 new 4G smartphones in the quarter, which are partially offset by a net decline in 3G smartphones, resulting in 456,000 net new smartphones. Total postpaid phone net adds totaled 167,000, which included a net decline of basic phones.

Tablet net additions totaled 196,000, which was 764,000 less than last year, due to lower gross adds and higher churn resulting from previous years' promotions. Full-year postpaid net additions of 2.3 million included 1.8 million of 4G smartphones and 1.4 million 4G tablets. The primary offset to these net additions was net declines in basic phones and 3G smartphones.

Postpaid gross additions improved sequentially to 4.2 million for the fourth quarter and to 15.4 million for the full year. Our disciplined focus on customer retention resulted in retail postpaid phone churn of less than 0.9%. Overall, our retail postpaid churn increased year over year due to higher tablet churn to 1.1%.

Total postpaid device activations totaled 13.1 million in the quarter, down 1.9%, and 43.2 million for the full year, down 7.3%. About 85% of these activations were phones, with tablets accounting for the majority of the other device activations.

About 8.3% of our retail postpaid base upgraded to a new device in the fourth quarter, up sequentially and consistent with prior year. During the quarter 8.6 million phones were activated on device payment plans.

Net prepaid devices declined by 9,000 in the quarter, compared to a decline of 157,000 in the prior year. We are seeing sustained year-over-year improvement in retail prepaid.



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We ended the year with 114.2 million total retail connections, excluding wholesale and Internet of Things connections. Our industry-leading postpaid connections base grew 2.1% to 108.8 million and our prepaid connections totaled 5.4 million.

Let's move next to our Wireline segment, starting with a review of our consumer and mass markets revenue performance on slide 10.

In the Wireline segment consumer revenue increased 0.2% and mass markets, which includes small business, declined 0.2% in the fourth quarter. For the full year, consumer revenues expanded by 0.4% and mass markets declined by 0.3%.

Fios total revenue again increased 4.4% in the fourth quarter and increased 4.6% in 2016. Fios revenue growth was primarily driven by an increase in the total customer base and strong demand for higher internet speeds. In Fios internet, we added 68,000 net customers for the quarter and 235,000 for the year. We now have a total of about 5.7 million Fios internet subscribers, representing 40.4% penetration.

In Fios Video, we added 21,000 net customers in the quarter and 59,000 for the year, and now have a total of 4.7 million Fios video subscribers, which represents a 34.3% penetration. Similar to prior quarters, we continue to see strong demand for custom TV offerings. Our One Fiber initiative in Boston is progressing as expected and we launched consumer and business services to customers late in the fourth quarter.

We continue to innovate with our Fios platform, utilizing our fiber assets and earlier this month we introduced Instant Internet, which is a new service that offers both upload and download speeds of 750 megabits per second. This service was introduced in New York, New Jersey, Philadelphia, and Richmond, and other markets will see the service soon.

Let's turn to slide 11 and cover enterprise and wholesale, as well as the Wireline segment in total.

Global enterprise revenue declined 4.5% and, on a constant currency basis, was down about 4% in the fourth quarter. For the full year, global enterprise revenue declined 3.6% and on a constant currency basis was down about 3%.

In our wholesale business, as expected, revenues declined 7.5% in the fourth quarter due to the impact of nonrecurring items in the prior year. For the year, wholesale revenue declined 4.9%.

Total operating revenues for the Wireline segment declined 3.1% in the quarter and 2.3% for the full year. The impacts of the labor contract, workforce reduction, and tight cost control supported improved profitability while maintaining strong customer satisfaction.

The segment EBITDA margin was 24.1% for the quarter and 19.6% for the year. We expect to see continuing improvement on an annual basis with seasonal fluctuations. Capital spending in Wireline was \$1.6 billion in the fourth quarter and totaled \$4.5 billion for the year.

Regarding our pending Wireline transactions, we expect the acquisition of XO Communications to close in the first quarter and the data center transaction to close in the second quarter. Let's move next to slide 12 to discuss our strategic position.

Entering 2017, we are confident in our strategy and priorities for future growth and profitability. The foundation of the three-tier strategy begins with our commitment to invest in our best-in-class networks. Above the network layer resides our platform layer, which we are developing and creating new business models to monetize the ever-increasing digital traffic growth.

Our goal is to be the trusted provider of connecting people and things and providing scalable solutions and analytics. Network quality and leadership is the cornerstone of this strategy and at the forefront of our brand value proposition to our customers. Today we are the largest and most reliable 4G network in the country, with market-leading fiber assets.

To expand our network leadership, we are executing on our strategic efforts to densify the 4G network, increase fiber resources, and enhance spectral efficiency. As I noted earlier, we have initiated our next-generation fiber network deployments in Boston.



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Fiber is an important element of our Wireless networks, as it allows us to strengthen our 4G LTE capacity while also preparing for 5G. Our pending XO Communications acquisition will add to our fiber footprint and provide us with additional metro rings in 45 out of the top 50 US markets.

5G wireless technology is a focus for us. We are now launching about 10 precommercial pilots across the country with multiple use cases, including dense urban and suburban neighborhoods. Our goal is to test the 5G fixed wireless technology in different environments in order to successfully operationalize 5G products for a commercial launch.

As noted earlier, we are expanding platforms and building new business models to monetize digital mobile video traffic on our network. In our media assets, AOL's content and ad tech capabilities have enhanced our video offerings. With a focus on delivering timely short-form versions of video clips, we have seen digital video consumption gain traction in the last year.

At the content and solutions layer of our three-tier strategy the combination of AOL, go90, and other content has enabled cross-platform sharing. This strategy expands our distribution and revenue opportunities globally across carriers and networks. We have seen increased usage in the go90 application through this exchange and we are expanding our unique content offerings.

The average daily usage in go90 was consistent sequentially at about 30 minutes per viewer with less than 20% set of traffic served on the Verizon Wireless network in the second half of the year. We are actively leveraging our content portfolio and have strategically focused on an ad-supported model. In 2016, through our joint venture with Hearst, we launched unique content through Complex Media and AwesomenessTV and we are looking forward to expanding these offerings this year.

In addition, our extensive digital rights portfolio, including sports such as NFL and NBA, provided enhanced viewing experiences such as launching Stream Pass to Verizon Wireless customers across multiple demographics. Our pending Yahoo acquisition would further increase our opportunity to scale in the digital media space with its 1 billion-plus monthly average unique viewers. We are still working with Yahoo to assess the impact of the breaches and we have not yet reached any final conclusions yet.

The Internet of Things, including telematics, is an area of opportunity that is rapidly growing as the connected world expands. Ubiquitous and reliable coverage to support the vast number of devices expected on these various platforms is a competitive advantage and we are developing this ecosystem to leverage our best-in-class networks, while providing solutions to verticals such as transportation, energy, agriculture, and smart cities.

The great example of this is in the telematics space, with acquisitions of both Telogis and Fleetmatics we became the market share leader. Our smart city solutions continue to progress and the business is augmented with the acquisitions of Sensity and LQD WiFi. As a result, we now have a deep inventory of solutions on our IoT platform to provide to our customers.

Overall, we are confident in our ability to execute, deliver results, and return value to our shareholders while continuously transforming the business. As we look at our current and pending assets in the media and IoT businesses, we will be focused on integrating these assets by increasing global scale organically and further enhancing cross-platform content sharing opportunities.

Collectively, these assets allow us to participate in the global ecosystem of the connected world. We see a clear path to revenue contributions from these integrated assets, which will drive returns to the overall business in a less capital-intensive manner.

Now let's turn to slide 13 to review 2017 priorities.

In 2017 our focus will be leveraging our network leadership position. We will focus on retaining and growing our high-quality customer base in both Wireless and Wireline, while balancing profitability in this dynamic environment. Enhancing ecosystems in media and the Internet of Things, led by telematics, will further drive the monetization of our network and solutions both domestic and globally.

We expect full-year consolidated revenue on an organic basis to be fairly consistent with that of 2016, with improvement in Wireless service revenue and equipment revenue trends. We also expect full-year consolidated adjusted EPS trends to be similar to consolidated revenue trends.



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Additionally, we are targeting the following for 2017: consolidated capital spending between \$16.8 billion and \$17.5 billion; minimum pension funding requirement of approximately \$600 million; and in terms of income taxes, we expect our effective tax rate for financial reporting purposes to be in the range of 34% to 36%, based on current legislation. We will execute on the long-term strategy to position the business for the future.

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

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**Michael Stefanski** - Verizon Communications Inc. - SVP, IR

Thank you, Matt. Tori, we are now ready to take questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Simon Flannery, Morgan Stanley.

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**Simon Flannery** - Morgan Stanley - Analyst

Thanks very much. Good morning. Matt, maybe we could start with the last point on the guidance.

Can you just give us a reconciliation of the new guidance versus the previous GDP-type growth and normal type EPS? What are the changes that are causing that?

And on EPS specifically, can you just help us reconcile what the base number that you will be using for sort of a flat kind of organic number would be, for all the adjustments with Frontier and the labor dispute, etc.? Thank you.

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

Thank you, Simon, for the question. Good morning. Let's start with the outlook we gave this morning and I'll start with the revenue. As you saw from that, we said we expect to see it consistent with 2016 on an organic basis and we continue to see the revenue trajectory of the business improve.

So as you saw in the release, we expect that to be fairly consistent on an organic basis, so this is an improvement over 2016, when revenue declined 2.4% on a comparable basis. Let's unpack that for a second and see how we get to that improvement from the negative 2.4% up to something that's more comparable.

Obviously, the major driver is Wireless, where total revenue was down 2.7% last year and service revenue was down 5.4%. So if we look into the service revenue component there, that trajectory improved throughout the year.

We started in the first quarter of 2016 down 6.2%. We ended the year in the fourth quarter down 4.9% and the year as a whole averaged down 5.4%, as I said. So as we expect that trend to continue to get better, we should see a better number year over year in Wireless service revenue.

Equipment revenue should also be higher, given the higher device payment take rate, which we expect to be similar to what we saw in the fourth quarter, which was at 77%. And so obviously improvement in Wireless will be the biggest factor year over year.

And as you look at the other parts of the business, we expect Wireline revenue trends to be similar to 2016; and then media co, we expect that will continue to build off the progress made last year. And then within the IoT businesses, obviously including telematics, that grew at 21% in the fourth





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quarter and we expect that business to continue to grow at a very healthy pace. So, on a combined basis, we are confident in seeing a better revenue trajectory in 2017 than last year.

When you talk about the -- how we gave the outlook on revenue versus what we've been saying previously, I think the biggest item you've got to look at in there is Wireless service revenue. So we continue to make good progress transitioning the base to unsubsidized service pricing.

As customers come out of their two-year subsidy plans, we see them quickly migrate to the unsubsidized service pricing. We ended the year with 67% of postpaid customers now on those unsubsidized pricing plans. And so, while we were happy to have seen the acceleration, it does provide a headwind to service revenue.

And then additionally within service revenue, we saw a higher level of migrations than in past pricing changes to the plans that we introduced in the middle of last year. That functionality of those new plans appealed to our base and we saw customers take advantage of that and optimize their plans. So those two developments especially have essentially pushed out our expectation of the timing of service revenue to return to year-over-year growth from the end of 2017 into 2018.

And so then, as you look at the earnings side of it, obviously the largest driver of EPS changes is what happens in the Wireless service revenue. Obviously, with service revenue being \$66 billion, more than [half](corrected by company after the call) of our total revenue, it's the largest driver. So that's -- we continue to work through that service review migration.

It is offset by the strong cost management we have had across the business and that has been a hallmark of our performance over the past few years, using the Verizon Lean Six Sigma program that you've heard us talk about previously. And that will continue to produce significant benefits in 2017. We will also see a full-year benefit in 2017 from the new labor contract.

So when you factor in all of the above, we expect to produce strong earnings again in 2017. And we talked about the trend we expect on EPS. You've obviously got the impact in 2016 of one year of the Frontier properties in the first quarter and obviously the work stoppage, but in total it will be around -- the revenue lines, they will be around where we were in 2016 as the baseline of our view for 2017.

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**Simon Flannery** - Morgan Stanley - Analyst

Okay. So just to be clear, on the EPS, we should take the EPS that you reported for 2016 as the base for 2017?

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

That's a reasonable starting point, yes.

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**Simon Flannery** - Morgan Stanley - Analyst

Okay, great. Then just one last thing on the optimization; has that sort of faded at this point or is that -- is that still continuing at quite a pace? Was that kind of a three- or four-month effect? Are you still seeing a lot of that going on?

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

We are seeing that still continue, but we saw it at certainly an aggressive pace initially after we launched those plans. That just means the base moved quicker to those plans than we'd seen in other changes. So we're excited that we launched product features that were of high level of interest to our customers.



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**Simon Flannery** - *Morgan Stanley - Analyst*

Great. Thanks, Matt.

**Operator**

Phil Cusick, JPMorgan.

**Phil Cusick** - *JPMorgan - Analyst*

Thanks. Just a follow-up first on Simon's question. Can you give us explicitly what the revenue number you're looking at in 2016 as sort of the normal number, as well as the earnings number?

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

Yes, the normal number for 2016 would be the comparable against the down 2.4% when you adjust out for the acquisitions over the course of the couple of years.

**Phil Cusick** - *JPMorgan - Analyst*

Sorry (multiple speakers) so exactly the dollar number that we should be starting with as the baseline to build from.

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

I'll come back to you on that one to say we refer off the down 2.4% year over year. It adjusts out for the transactions in both 2016 and also the AOL introduction in 2015. So when you adjust for both of those, the number --.

**Phil Cusick** - *JPMorgan - Analyst*

Right, and I'm just -- I'm sorry; go ahead, Mike.

**Michael Stefanski** - *Verizon Communications Inc. - SVP, IR*

I was just going to say we will get you that exact number because it is both taking out Frontier for the first quarter as well as we do make an adjustment because we didn't have a full year of AOL. So that's how we get to the negative 2.4%.

But effectively what we are saying is that, organically, that was not including any of the growth for new businesses; that would be the consistent number. But we will get you that exact number.

**Phil Cusick** - *JPMorgan - Analyst*

Okay. Then just to make sure; when you talk about better trends -- and it sounds like you are looking for stability -- that revenue number you are looking for dollars of stability year over year; not stable down-tick in percentages, correct?



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

Correct.

**Phil Cusick** - JPMorgan - Analyst

Not down 2% [revenue] (multiple speakers)?

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

Correct. Consistent on a dollar basis year over year and we get there through seeing improvements in the trend on the service revenue trajectory, the equipment revenue trajectory, so in total across Wireless. And then also the newer businesses, whether it be media co or across the Internet of Things businesses, we continue to expect to see those -- the revenue from those businesses improve in 2017.

**Phil Cusick** - JPMorgan - Analyst

Okay, that makes sense. Then on earnings is it \$3.86 that we are using as the baseline from 2016 to jump off into 2017? Or is that a different number?

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

I'd go off of the \$3.87 that we had on an adjusted basis, adjusting out for the mark-to-market and other items.

**Phil Cusick** - JPMorgan - Analyst

\$3.87, got it. Then if I -- just to add one more new one. You talked about the GAAP tax 34% to 36%. How should we think about cash taxes in 2017 under the current legislation?

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

We would expect cash taxes to converge towards the effective tax rate during 2017.

**Phil Cusick** - JPMorgan - Analyst

So a higher cash tax rate in 2017 than 2016?

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

Yes, the cash tax is just purely on income. Obviously our cash taxes for 2016 did include \$3.2 billion of taxes related to the Frontier transaction. We would expect to have cash taxes in 2017 related to the disposal of the data centers when that occurs at a lower level, but on the organic tax on earnings, we would expect the cash taxes to be closer to the ETR during the course of 2017.

**Phil Cusick** - JPMorgan - Analyst

Okay. And do you have any initial thought on what the different plans of tax changes could be? Anything you can help us as we model out the different impacts from order adjustments and things like that?



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

As we look at taxes we certainly -- look, it's a little too soon to tell. We certainly are supportive of changes in the tax legislation. We believe that we need to get to a more competitive tax environment and we look forward to working with Congress and the new administration as they try and put new tax rates forward.

Certainly a reduction in the rate would be beneficial. 100% expensing of CapEx would be beneficial initially, but the plans being discussed also include items such as removal of the interest expense deduction. And then, as you mentioned, we are all trying to understand exactly how border adjustability may or may not work.

So certainly believe that tax reform would be a benefit to us, whichever year is the first year it applies to. Whether it applies to 2017 or whether it initially applied to 2018, it would definitely -- we are definitely seeing it being a benefit to the cash taxes we pay. But given the uncertainty on the specifics of the plans, it's a little too soon to say exactly how much that could be.

**Phil Cusick** - *JPMorgan - Analyst*

Can you give us an idea of within your CapEx and OpEx what, either a dollar or a percent, comes from overseas? Then I'll stop, sorry.

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

I don't think we've disclosed that number previously, so we would have to go back and look that up. But, no, we are not going to disclose that at this time.

**Phil Cusick** - *JPMorgan - Analyst*

Thanks very much.

**Michael Stefanski** - *Verizon Communications Inc. - SVP, IR*

Phil, there is a reconciliation of the number for revenue that we are using in our financials that we released this morning on our website, but the number is \$121.8 billion. So \$121.8 billion would be the base for the revenue as we discussed.

**Phil Cusick** - *JPMorgan - Analyst*

Thanks, Mike. Great.

**Operator**

John Hodulik, UBS.

**John Hodulik** - *UBS - Analyst*

Great, thanks. Maybe another follow-up on the guidance. Matt, obviously there's a lot of moving parts, but with the revenue trends and EPS trends sort of mirroring each other it seems to suggest roughly sort of flattish margins. But you're leaving the year with real strength in wireline profitability, so first of all, if you could talk about what's driving that.

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And the expectation is for that to continue. Does that imply that the margins on the Wireless side looking out into 2017 should be flat to maybe even down? And maybe talk a little bit about that trend, especially given the help that you should see from the removal of subsidies in the year.

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

Thanks, John, for the question. Starting off with Wireline, certainly Wireline had a good result in the fourth quarter. I would tell you, as we said in our prepared remarks, that we would expect Wireline margins for 2017 and the year as a whole to be higher than they were in 2016. And you will see some seasonal fluctuations in there, as we typically do, so I would tell you it would be reasonable to expect Wireline margins for the year as a whole to be in the low 20% compared to the 19% that we saw for 2016.

So we see a lot of improvements going through the business there. Obviously, we're going to have the full-year benefit of the new labor contract through there and we continue to manage costs in that business very closely in line with the revenue trajectories. We continue to see kind of similar revenue trajectories for the enterprise and wholesale businesses and are excited about the Fios business, which was up last year 4.6% on a full-year basis for Fios revenues, and we continue to have more open-for-sale properties there that creates opportunities as we head into 2017.

On overall margins, and you talk about the Wireless margins, this always comes back to where the service revenue trajectory is going to be. And so we certainly see improvements in service revenue year over year, but we do go into the year off that 4.9% jump-off point from the fourth quarter and we expect to see that continue to improve as we head into 2017. But as I said, we now see the point at which we get back to year-over-year positive number pushing out into 2018.

And so I would expect us to continue to have very strong margins in the Wireless business, but it's going to be off of that service revenue trajectory continuing to be slightly negative, though in an improving direction.

**John Hodulik** - UBS - Analyst

Do you think that on a net basis you can keep those Wireless margins flattish?

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

Yes, we will continue to aim to produce strong margins in that business and certainly believe that we have the ability to maintain a premium pricing in the market. That will certainly be our aim as we go through the year.

**John Hodulik** - UBS - Analyst

Great. Thanks, Matt.

**Operator**

David Barden, Bank of America Merrill Lynch.

**David Barden** - BofA Merrill Lynch - Analyst

Thanks for taking the questions. I guess two if I could. First, Matt, obviously a lot of focus on the guidance. Taking maybe \$2 billion to \$3 billion of revenue out of that number; it feels like something has changed on the ground competitively that is making you have to really get more aggressive on the EIP side and then the promotional side.



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Do you feel like Verizon needs to go to market more aggressively with an unlimited product, like each of your competitors has and is kind of leading with these days? If you could talk about your view; we all knew Fran's views on the economics of that, but I would love to hear what your perspective is on the necessity that you do that and your ability to do that if you chose to.

Then the second thing, just now with Ajit Pai's elevation to the Chair, do we have greater clarity on the likelihood that we're going to be getting rid of the privacy rules specifically aimed at telecom; also the opportunity to maybe more aggressively monetize broadband? Could you talk a little bit about some of the opportunities and actions that you might be taking right now to prepare for the next regulatory wave? Thanks.

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

Thank you, David. I'll start with your first question. As we look at our market position, it's based off the product offering and we have the best network performance out there, which is a major criteria in the user experience.

Despite the claims of others, third-party studies continue to demonstrate the superiority of our network and this network leadership position, obviously, allows us to maintain a premium price for our service in the marketplace. So as I look at it, our service revenues plus installment billing, so the total amount we're actually billing a customer each month, that increased 2% in 2016. So that demonstrates our offerings continue to be a competitive and resonate in the marketplace.

We constantly monitor the competitive market; look for opportunities to compete more effectively. An example of that, we recently launched new single-line pricing which we believe was an underpenetrated market for us. Our pricing is disciplined to provide a return for our premium service.

There is a number of different offers out there. We saw some folks go to unlimited; we saw some bundling of content and so on in the marketplace. We continue to assess where we are in there, and as I say, I think our results -- we had 167,000 net phone adds in the quarter, so I believe our positioning continues to be competitive.

We constantly look at to what's out there. Unlimited is one of the things that some of our competition has at this point in time; that's not something we feel the need to do. But as I say, we continually monitor the market and we will see where we head in the future.

In terms of your second question, so look, there's a lot of changes going on in DC right now. Obviously yesterday we saw the announcement that, as you mentioned, of Ajit Pai and so that may have a number of impacts across the regulatory space, but I think it's just too soon to tell exactly where we are going to be. We look forward to working with the regulators, whether it's the FCC or others.

The other thing that I would mention, though, as you think about that, we make investments for many years given the nature of the business that we are in. And our investments aren't focused on just who happens to be in office today. We're making investments that are for 10-plus years and I think our record stands for itself, that irrespective whoever the administration is run by and the regulatory regime, that we are effective. And that will continue to be how we focus our investments.

I'd say we look forward to working with the new administration and the new leadership in the FCC, and we expect to continue to be competitive in whatever environment we are operating in.

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**Operator**

Craig Moffett, MoffettNathanson.

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**Craig Moffett - MoffettNathanson - Analyst**

Good morning, guys. I wanted to step back to a bigger picture question, if I could.



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Matt, given the comments that you made in the press release about getting the balance sheet back to the pre-Vodafone deal levels, how much room does that leave you before 2018, 2019 for strategic transactions? There's been a lot of speculation about the types of things that you might do in this new environment, whether it's content or wireline or spectrum or none of the above.

I wonder if you could just give us some thoughts on how much flexibility you have and how you think about the various vectors of opportunity for you.

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

Thanks, Craig. As you mentioned, we have been on this path to getting back to the pre-Vodafone credit metrics by 2018-2019 and that is part of our overall capital allocation. We have been able to be consistent with investing in our networks on a continuous basis, making that improvement in the balance sheet, and also returning value to shareholders.

And since the Vodafone transaction we've had a number of activities that we have done, whether that be AOL, some of the other acquisitions in IoT, such as Fleetmatics. We've also divested of businesses, whether it be the Tower transaction as an example. And so we have been able to continually make strategic transactions while staying consistent to each part of that capital allocation policy.

That will be our intent to continue to do so. As we head into 2017, we believe that we will be able to continue to maintain that capital allocation policy that allows us to deliver on all three of those key areas.

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**Craig Moffett** - *MoffettNathanson - Analyst*

Matt, can you comment on how you think about the various options out there, whether it's content or wireline or spectrum or something else?

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

Obviously, look, I'm not going to comment on any specific combinations that have been rumored over the years and certainly we are not able to talk specifically about spectrum right now, given that we are in the incentive auction.

So we will continue to look for opportunities to expand and grow the business. Lowell and I are completely aligned that we will be disciplined in any investment activity. We evaluate all options, whether that is build, buy, or partner for our strategic positioning, and the key criteria is creating long-term value for the business and shareholders.

We will continue to look for the right things to do to position the business to be successful in the future. And that is -- we do that on an everyday basis and we will continue to do so. And I think we've successfully done that over the past few years.

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**Craig Moffett** - *MoffettNathanson - Analyst*

Thanks, Matt.

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**Operator**

Mike Rollins, Citigroup.

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**Mike Rollins** - Citigroup - Analyst

Thanks and good morning. Two, if I could. First, if you could talk about how the 5G business case is progressing from a financial perspective. And, Matt, what are the key metrics that you are looking for from the team that's working on the business case to facilitate a green light of commercial deployment? Is there certain costs metrics, like per home passed, or certain other metrics that you are focused on?

Then, just if I could follow-up on a clarification. I think you mentioned that in terms of thinking about flat organic revenue for 2017, you took the revenue for 2016 and you subtracted the divestiture of markets to Frontier and you subtracted AOL. Can you help us think through what the add-backs then are for 2017 with the number of pending and completed acquisitions that you announced and are still in progress? Thanks.

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

Thanks, Mike. Let me start off with 5G. Look, we had good progress in 2016, as we discussed throughout the year. We had a number of technical trials and lab scale trials which we completed and so we've now moved on to the next phase of that, which is some of these commercial scale pilots that are getting underway right now in about 10 different locations around the country.

We are very excited about the opportunities that 5G brings. We will see how those trials go and we look forward to sharing progress with you on those as we move forward throughout the year.

You asked around key metrics. I think it's going to be the same as any major investment we could be looking at, just a combination of what's the cost to rollout 5G. We get into questions about how -- the distance from the node; how many homes can you cover from any particular node? What speeds can we get? What's the cost of putting that there, etc., etc.?

XO obviously brings something to that by adding additional fiber to the base as we think about rolling out the infrastructure needed for 5G. And -- but it's the same as any investment, Mike. We are going to look at the revenue opportunity we think we can get based off of the results of the tests that are underway right now, compare that with the cost, and if it provides a great return for shareholders, we will certainly move ahead with launching commercially. And if -- it will be the same as any other investment; we will look at it the same way.

In terms of your second question on 2016, you're right; the baseline is reducing the Frontier divestiture and also AOL, because we only had it for partially -- part of the year in 2015. So then if you think about total revenue for 2017, it would include obviously the full year of AOL this year. We expect XO to kick in later this quarter.

We expect the IoT businesses -- you're going to have the full year of Fleetmatics and Telogis and the other IoT acquisitions. And then, assuming the Yahoo transaction closes, you will have the revenue from there, too. So when you think about building on the number that Mike mentioned, the \$121 billion, you got all those things to layer on top of that to get to the expectation for the full year.

Obviously, as it relates to pending transactions, it will be contingent on the timing of those as well. So hopefully that answers your question on that.

**Mike Rollins** - Citigroup - Analyst

Thanks very much.

**Operator**

Brett Feldman, Goldman Sachs.





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**Brett Feldman** - *Goldman Sachs - Analyst*

Thanks for taking the question. If I look at your CapEx guidance for the full year, it essentially seems you're guiding to flat, plus or minus a reasonable range. I was hoping you could maybe unpack that a little bit.

And just thinking about your network strategy and your product strategy, what areas are you accelerating capital investment inside the business? Maybe where do you feel like you've done a good job building out your network where it needs to be? Thanks.

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

Thanks, Brett. As you think about the CapEx, as you say, the number is reasonably consistent year after year and that's something you've seen from us for a number of years. But, as you say, within that it changes over time.

So within LTE our spending continues to transition from coverage to densifying the network. And that continues to evolve as we leverage new technologies around radio and hardware and software and then refarming our spectrum within 4G and densifying with small cell.

So you will continue to see that densification of the 4G network. And that includes how we put fiber out there, which obviously is needed for the 4G network, but also is something that we think about for prepositioning for 5G. So you will continue to see that.

You will continue to see us launch additional parts of LTE Advanced as we go through that. We had the initial launch of that last year. We expect additional features to come during the course of this year and we will continue to expand our C-RAN architecture.

So within Wireless you should expect to see the spending continue to move to make the network more efficient on a cost-per-gig basis going forward. Then, as we've mentioned, fiber is a consistent part of our business so that is something you should expect to see us continue in. We've talked about what we're doing in Boston; you should continue to see us do that.

Some of the other businesses aren't -- as we've said previously, they are not as capital intensive as our network business, so you should expect to see that CapEx will continue to be focused on the network side of the business as we go into 2017.

**Brett Feldman** - *Goldman Sachs - Analyst*

Just a quick question as a follow-up around where you're investing; you talked about the precommercial, the 5G commercial trials you're running. Are those predominantly within your wireline footprint? Or do you actually think that when you are ready to go commercial you have a business case to go in whatever markets look like they have the best demographics, regardless of whether you are an incumbent wireline provider or not?

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

It's not just in the ILEC footprint; it's across the country and we certainly see the opportunity to deploy 5G solutions across the country as well. Once we get comfortable with it, they are ready to be launched out on a commercial basis.

**Brett Feldman** - *Goldman Sachs - Analyst*

So you could do One Fibers in markets across the country, not just in Boston?

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

Yes, certainly we're looking at how we would support the 5G network across the country, both in and outside the ILEC footprint.

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**Brett Feldman** - *Goldman Sachs - Analyst*

Thank you.

**Operator**

Mike McCormack, Jefferies.

**Mike McCormack** - *Jefferies - Analyst*

Thanks. Matt, maybe just a clarification on your comments regarding service revenue turning positive. Just give us a sense; obviously optimization continues, but is that predicated on a stable pricing environment in your view?

Secondly, on the retention side, it looks like you've got about a 21% delta between those that are on unsubsidized plans versus those making device payments. Is that fair? And then, as we think about that, how much of that is bring your own device versus off-contract versus your own retention efforts?

And then, if you don't mind, a final one. Based on our math, it looks like you still have about 13.1-ish-million feature phones out there, so non-smartphones. What is the strategy to try to move those over to smartphones or try to retain them to prevent headwinds on handsets as we look into 2017?

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

Thanks, Mike; I'll start with the last one. Look, we certainly like it when customers migrate from feature phones to an LTE smartphone, but we are also very happy for those customers that just want a feature phone. They are not looking for the additional functionality, but they want to be connected to a great network. We are very happy to continue to have those as customers and we look forward to continuing to have offerings that meet their needs as well.

In terms of service revenue, and I think you talked about the gap between the 46% of our customers who have a device payment plan and the 67% of our base who now are on unsubsidized pricing. That's a factor of as customers come out of their two-year service contracts and they move over to that pricing without necessarily upgrading a handset and we expect that will continue.

That delta between those two numbers will be those customers who have either come out of two-year subsidy and moved over to the unsubsidized pricing. They could be -- we now have customers who took out a device payment plan over two years ago who have completed those payments and are now no longer making a device payment every month. And as you say, BYOD continues to be part of that base, too.

So you should expect there continue to be a delta between those two numbers, because not everyone on unsubsidized pricing is going to have a current device plan. We see that continuing as we go into the year and part of the (multiple speakers) migrating over to device payment.

**Mike McCormack** - *Jefferies - Analyst*

Sorry, just a clarification. I guess I'm trying to get to how much of that -- I'm sorry to interrupt -- but the actual percentage of that that is you going into actively retain customers that are still on contract, to reduce their price point without losing a customer. Is there some component of that as well?



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

Yes, the vast majority of our two-year customers who have gone on to the unsubsidized pricing is when they've come to the end of that. We typically -- customer has to get through their two-year price plan, if they are on that two-year service contract, before they would then be able to come to the unsubsidized pricing.

When you look at our churn, I think what you're trying to get to is that phone churn that was below 0.9%. And that is not because we are bringing customers onto that pricing before they've moved there. I think that continued strong churn represents the value our base sees in the service they get and the high quality of the network that they have when they are a Verizon customer.

It's only when they come out of their two-year contract do they move over to -- have the opportunity to move over to unsubsidized pricing.

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**Mike McCormack** - Jefferies - Analyst

Thanks for the clarification. Just on the service revenue expectations, is that -- stable pricing is the expectation there or expecting additional promotions as we look at 2017?

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

Yes, we expect to continue to compete in the marketplace as throughout 2016. We did various promotions throughout the year; I would expect us to continue to at different times of the year have different promotions out there. But I expect, based off that, we will compete effectively in the marketplace.

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**Mike McCormack** - Jefferies - Analyst

Great. Thank you, Matt.

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**Operator**

Amir Rozwadowski, Barclays.

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**Amir Rozwadowski** - Barclays Capital - Analyst

Thanks very much and good morning. Just a quick follow-up on Brett's questions on fiber. Specifically, how should we think about your future fiber needs?

It seems like in some context you are willing to shed certain assets, but have also acquired others, and are also working with third-party providers. In some cases, overbuilding in areas such as Boston.

What I'm trying to understand is that based on your actions, it seems as though not all fiber assets are created equal. And so how do you get to the point where you have the right fixed assets in the right locations to support your network vision? And I've just got a brief follow-up.

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

Good morning, Amir. Thank you for that. Fiber is going to be a critical asset for us. It's a critical asset today and it will certainly continue to be so as we go into the future.



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One thing it allows us to do -- and this certainly is within our footprint -- is it replaces the core copper networks that have served us well over the years. But from a capability standpoint and also just a maintenance standpoint, it certainly makes a lot of sense for us to continue to replace copper with fiber. Then, as you say, fiber is going to be critical for us as we densify 4G and think about 5G. That explains why the XO transaction was interesting to us; getting those metro rings in 45 of the top 50 markets.

The other thing you have seen us do in Boston was really look at this One Fiber approach, which was building a network in a way that provides a common fiber infrastructure to serve a number of different needs, whether that be consumers in in-home or out-of-home, and then obviously our small, medium, and enterprise customers, too.

So you should continue to see us deploy fiber. How we deploy that fiber can differ from location to location. We certainly look where it makes sense for us to own the fiber, but if there is ways for us to partner with other people or they can build the fiber on our behalf, we certainly do that as well.

So it's a location-by-location, case-by-case basis. We look at the economics and we decide the best way to get to the fiber assets that we need. And we think about that it's not just the fiber assets that we need for what we are doing today, but as we think about the network going out into the future. You should continue to see us make investments in fiber as we go forward and position the network to service the business well into the future.

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**Amir Rozwadowski** - *Barclays Capital - Analyst*

Great. Just a quick follow-up on your 2017 outlook. What type of factors do you take into account on any potential changes to the competitive landscape? In particular, Comcast has highlighted that they expect to launch their WiFi MVNO strategy in the back half of the year.

Given you folks are partnered there, I was wondering what you are factoring in with respect to that partnership in terms of size and impact to both your financials and potentially the competitive landscape.

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

Yes, so as I think about -- look, we know they said they expect to launch that later in the year. We'll have to wait to see what it is.

As we've said previously, look, we've been in the wholesale business for many years. We are happy to be in that business and we would sign that agreement again if the opportunity came up. But, look, we don't expect that to necessarily have a major impact during the course of 2017. They've got a lot of work to do there and I'll let them talk about their strategy on that.

But as I think about the competitive environment as a whole, I would expect it to continue to evolve in ways that -- some of which we may guess and others of which we will have to wait and see how they play out. But what I would remind you is that we've seen many different competitive environments over the past 15, 20 years in wireless and I think the one constant has been the way that we have always competed effectively whatever the environment. And I would highly expect us to do the same thing in 2017.

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**Michael Stefanski** - *Verizon Communications Inc. - SVP, IR*

Thank you for your questions. Tori, before we end the call I would like to turn the call back to Matt.

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

Thanks, Mike. I would like to close this session with a few key points. In 2016 we delivered solid results in a competitive environment. We added quality customers while leading the industry in network performance and customer retention. We had solid financial results generating cash flow and shareholder return.



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We are confident in our strategy and priorities led by investing in our networks, creating platforms to further monetize data usage, maintaining a disciplined capital allocation model, and returning value to our shareholders. We are positioning the Company for long-term growth.

A key foundational element for our vision of the future is to be the trusted network provider. Our strong network assets will enable us to be a centerpiece of this new connected world of people and things and give us the opportunity to participate globally in advancing digital ecosystems.

We look forward to the opportunities ahead of us to create value for our customers and shareholders. Thank you for your time today.

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### Operator

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

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### Editor

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