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# EDITED TRANSCRIPT

VZ - Q4 2017 Verizon Communications Inc Earnings Call

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## OVERVIEW:

Co. reported full-year 2017 consolidated revenue of \$126b and GAAP EPS of \$7.36.  
4Q17 consolidated operating revenue was \$34b and GAAP EPS was \$4.56.



## JANUARY 23, 2018 / 1:30PM, VZ - Q4 2017 Verizon Communications Inc Earnings Call

### CORPORATE PARTICIPANTS

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

**Lowell McAdam** *Verizon Communications Inc. - Chairman and CEO*

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

### CONFERENCE CALL PARTICIPANTS

**Philip Cusick** *JPMorgan - Analyst*

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

**John Hodulik** *UBS - Analyst*

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

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

**Michael Rollins** *Citigroup - Analyst*

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

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### PRESENTATION

#### Operator

Good morning and welcome to the Verizon fourth-quarter 2017 earnings conference call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

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

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

Thanks, Brad. Good morning and welcome to our fourth-quarter earnings conference call. This is Brady Connor and I'm here with our Chairman and Chief Executive Officer, Lowell McAdam, and our Executive Vice President and Chief Financial Officer, Matt Ellis.

As a reminder, our earnings release, financial and operating information, and the presentation slides 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'd like to draw your attention to our Safe Harbor statement on slide 2. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. Discussion of factors that may affect future results is contained in Verizon's filings with the SEC, which are now available on our website.

This presentation contains certain non-GAAP financial measures. Reconciliation 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 on a year-over-year basis unless otherwise noted as sequential.

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

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**Lowell McAdam** - Verizon Communications Inc. - Chairman and CEO

Thank you, Brady, and good morning, everyone. I wanted to join today's call to talk about 2017 results, the implications of tax reform to Verizon, and then to talk about our strategic priorities for 2018.

Let me start off by recapping our impressive performance this year. I'm proud of the focus and the execution from our team in 2017. We regained positive momentum in the marketplace and delivered strong operational and financial results.

We launched and expanded the most reliable unlimited experience for our customers, executed the world's largest successful 5G precommercial trial, invested in assets and platforms for the future, and gained significant traction in the integration of new businesses.

We finished the year with great momentum in the fourth quarter as evidenced by our smartphone net additions and reoccurring levels of outstanding customer loyalty. In addition, the improvement in our wireless service revenue trajectory positions the business for growth moving forward.

The integration of new businesses is accelerating our mobile-first digital strategy and providing a platform for global reach. In 2017, we made significant progress with our Oath assets as we build engaging brands around the key pillars of news, sports, finance, and lifestyle and we leverage the Oath capabilities across all of our Verizon properties.

The game-changing content and technology partnerships that we recently announced with the NFL and NBA are great examples of how we are accelerating our digital rights strategy with Yahoo Sports and Verizon's family of digital media brands. We are becoming the first screen for fans of live sports and superior partners for advertisers, positioning us to show live action in the engaging ways people want to consume video content.

We are investing for the future while maintaining a well-rounded approach to funding all aspects of our business. We enhanced our financial profile in 2017 with a number of transactions that strengthened the balance sheet, that included lowering our borrowing costs, extending out our debt maturities, and making a significant voluntary contribution to the pension fund.

Now let's take a look forward. We ended the year with the President signing tax reform into law, effectively restructuring the tax code for US corporations. Verizon has long supported corporate tax reform that reduces rates to globally competitive levels and we are very pleased to see this legislation passed.

The new tax law will have a positive impact to Verizon's cash flow and earnings profile. We expect tax reform to enhance our cash flow from operations in 2018 by approximately \$3.5 billion to \$4 billion.

We have been disciplined in our approach to capital allocation since the inception of Verizon. We have always been focused on keeping our network the gold standard and investing in the business for growth while strengthening our balance sheet and maintaining strong dividend performance for our shareholders.

This will continue to be the driving force behind the use of cash savings from tax reform, and by strengthening the balance sheet, it will give us the flexibility to execute our strategies going forward.

Our employees drive the innovation and success of our business, so it's vital that we all share in the success of not only tax reform, but the overall performance of Verizon. We will provide details on how we are investing in our employees later today and we'll provide those details outside the Company later today.

We are good corporate citizens and share our success with the community. In 2017, Verizon and its foundation donated \$75 million for disaster recovery and community projects. We will increase our contributions to the Verizon Foundation by \$200 million to \$300 million over the next 2 years with the additional funds being dedicated to our efforts around Humanability.

And by Humanability, we mean applying our technology to making our customers' lives better. Combined, these two initiatives will have an approximate \$0.05 to \$0.06 impact to our earnings per share for each of the next two years.



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As we head into 2018, our strategic priorities remain clear and are unchanged. The cornerstone of our strategy continues to be our best-in-class Wireless network, which continues to be ranked number one in the nation in both voice and data network quality. Our unbroken run of J.D. Power and RootMetrics awards keeps getting longer.

In our history, Verizon has always been on the forefront of technology innovation. We've led the transformation of the wireless industry from analog to today's fourth-generation LTE service. Now we have an unprecedented opportunity in front of us as we drive the evolution of the US wireless industry to the fifth generation of mobile services.

Not too long ago, people were saying 5G would not be possible until sometime between 2020 and 2022. Only one carrier has been consistent in its actions and messaging regarding 5G. Verizon has the spectrum bandwidth needed to provide the rich services of true 5G, our intelligent edge network capabilities, and engineering know-how to lead the industry in providing the full suite of 5G gigabit services.

The investment in pre-positioning of assets that we have accomplished will enable us to deliver the full range of 5G services, including mobility, residential broadband, sub-millisecond latency applications, and other advanced consumer and IoT use cases. We have flexed our innovation muscle and are now taking 5G from a mere possibility to commercial reality by bringing three to five cities online this year with commercial services.

The next Industrial Revolution will be on Verizon's network and will positively impact society like no technology we have seen before. As we say around our offices, we don't wait for the future; we build it. And we are doing it again with 5G.

Now I will hand the call over to Matt to talk about the financial and operating details of the business, starting with slide 4.

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

Thanks, Lowell. It's great to be with you today and to share the results of our strong performance. In the fourth quarter of 2017, we reported earnings of \$4.56 per share and full-year earnings of \$7.36 per share on a GAAP basis. These reported results include several special items that I would like to highlight.

Our reported earnings include a net pre-tax loss from special items of about \$2.6 billion. This net loss consists of severance and mark-to-market adjustments for pension and OPEB liabilities of \$1.2 billion, early debt redemption costs of \$681 million, a charge for product realignment around early-stage developmental technologies of \$671 million, acquisition- and integration-related charges of \$154 million pertaining mainly to Yahoo, and a non-cash pre-tax gain on spectrum license transactions of about \$144 million.

Additionally, as noted in our 8-K filing last week, the new tax law resulted in a one-time benefit of approximately \$16.8 billion or \$4.10 per share. This benefit is primarily related to the remeasurement of our net deferred tax liabilities at the new 21% corporate income tax rate.

The cumulative net impact from these items after-tax was approximately \$15.2 billion or \$3.71 per share. Excluding the full effect of these items, adjusted earnings per share was \$0.86 in the fourth quarter, which is flat compared to our performance in the same quarter a year ago. For the full year, adjusted earnings per share was \$3.74.

Now let's move to a summary of the consolidated financial highlights of the quarter on slide 5. In the fourth quarter, total operating revenue was \$34 billion, an improvement of 5%. And for the full year 2017, revenue was \$126 billion.

On a comparable basis, excluding divestitures and new businesses, adjusted operating revenues declined approximately 2% for the year. For the full year, consolidated adjusted EBITDA, excluding special items, totaled approximately \$45.1 billion and consolidated adjusted EBITDA margin was 35.7%, slightly higher than last year's margin of 35.5%.

Let's turn now to our wireless results on slide 6. Our value proposition of providing unlimited service on the best network together with the simplicity of our offers is driving increased engagement from our valued customers.



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In the fourth quarter, total wireless operating revenue increased 1.7% to \$23.8 billion, our first positive year-over-year growth in two years. For the full year, operating revenue totaled \$87.5 billion, a decline of 1.9%.

The sequential results in service revenue increased for the second consecutive quarter by 0.2% to \$15.9 billion. On a year-over-year basis, service revenues declined by 2.9%, a marked improvement over the same period last year. The improved trends to service revenues are attributed to several factors, including increased access revenues and new account formation.

Our postpaid phone base migrations to unsubsidized service pricing are progressing and now represent approximately 80% of our postpaid phone base, approaching steady-state as most of our business customers remain on subsidized plans.

In the fourth quarter, equipment revenue increased to \$6.5 billion, up 12.9% for the quarter and 7.8% for the full year. At the end of the quarter, approximately 49% of our postpaid phone customers had an outstanding device payment plan balance.

During the quarter, we generated \$9.5 billion of EBITDA, an increase of 9.6%. Wireless EBITDA margin was 39.8% compared to approximately 36.9% in the same period last year. As expected, the improvement in EBITDA was a function of better trends in service revenue and lower promotional activity than the prior year. For the full year, we generated \$38.6 billion of EBITDA on total revenues of \$87.5 billion.

Now let's turn to slide 7 and take a closer look at wireless connections growth. In the fourth quarter, total smartphone net adds were 647,000 compared to 456,000 last year. Total postpaid net adds were 1.2 million, including phone adds of 431,000, 193,000 tablets, and 550,000 other connected devices, predominantly wearables. For the third consecutive quarter, we increased customer accounts, adding 40,000 to our base.

For the full year, postpaid net additions of 2.1 million included 774,000 phones, 31,000 tablets, and 1.3 million other connected devices. Our competitiveness in 2017 was highlighted by smartphone net adds of 1.8 million, up 34% versus prior year.

The overall experience of pairing our unlimited plan with the best network continues to resonate with our customer base, resulting in outstanding retail postpaid churn of 1.00% and phone churn of 0.77% in the fourth quarter. On a year-over-year basis, postpaid churn improved by 10 basis points, driven primarily by strong phone results.

In the quarter, postpaid device activations totaled 12.4 million, down from 13.1 million last year. About 82% of these activations were phones, with wearables accounting for the majority of the other device activations.

Our retail postpaid upgrade rate was 7.2%, up sequentially as expected, but was lower compared to the prior year. We are seeing the elongation of the upgrade cycle as more customers hold onto their devices for a longer period. During the quarter, 8.1 million phones were activated on device payment plans.

Prepaid net additions declined by 184,000 compared to a decline of 9,000 in the prior year. Our smartphone prepaid base increased during the quarter. All of the decline in prepaid net additions was due to basic prepaid phones, as we have deliberately reduced our focus in that area.

We ended 2017 with 116 million total retail connections, excluding wholesale and Internet of Things. Our industry-leading postpaid connections base grew 1.9% to 111 million and our prepaid connections totaled 5.4 million for the year.

Let's move next to our wireline segment on slide 8. Total operating revenues for the wireline segment increased 0.1% in the quarter and 0.6% for the full year. On an organic basis, excluding revenues from our XO acquisition, segment revenues declined in the quarter by 3.6%. Growth from our high-quality fiber-based products continues to be offset by secular pressures from legacy technologies and competition.

Consumer markets revenue decreased 1.4% in the quarter as Fios Internet growth was overshadowed by declines in video and copper. For the full year, consumer revenues grew by 0.2%. Consumer Fios revenue grew by 1.7% in the quarter.



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Fios revenue growth was primarily driven by an increase in the total customer base and strong demand for higher Internet speeds, including our gigabit connection launched early in 2017. In the quarter, we added 47,000 Fios Internet customers. We now have a total of about 5.9 million Fios Internet subscribers, representing a 40.1% penetration rate.

In Fios video, the business faced ongoing headwinds as observed throughout the linear TV market. The Fios video business ended with 29,000 subscriber losses in the quarter and 75,000 for the year.

Our multiuse fiber initiative is progressing as expected. This provides the foundational layer for multiple ways to interface with a wide array of customers and is the cornerstone of our intelligent edge network. We launched our partnership with Boston in 2016 and are seeing good results in that area.

We announced our public-private partnership with Sacramento in June of 2017. And you will see more activity from us on this front as progressive municipalities work with Verizon to bring new technologies to their communities.

For the quarter, excluding XO, enterprise solutions revenue decreased 4.1%. New customer wins and growth in advanced communication products were more than offset by secular and pricing pressures in our legacy offerings and technologies. Partner solutions revenue, excluding XO, decreased 5.8%. Strong demand for fiber access is a growth opportunity for this business.

In business markets, revenue declined 5.6% without XO. We are competing and winning with our fiber-based products, but continue to see declines in legacy technologies.

Segment EBITDA margin was 20.9% for the quarter and 21.1% for the year. Our commitment to operational gains and efficiencies in the business were largely offset by content cost escalations producing a stable margin profile.

Let's move next to slide 9 to discuss our media and telematics businesses. Our integration efforts for the Oath assets are progressing ahead of schedule. We remain focused on exploiting synergies across all of our media assets to create a streamlined platform with rich, engaging content and simple functionality.

For the quarter, Oath revenue was \$2.2 billion, an increase of approximately 10% sequentially. As expected, revenue trends were driven by increased advertising spend during the holiday season. And we expect to see the normal seasonality from fourth quarter to first quarter.

Our telematics business, which includes Fleetmatics and Telogis, continues to grow. Total telematics revenue increased to just over \$230 million. IoT revenues increased approximately 8% in the quarter on an organic basis. Our solution set is evolving as our engagement with municipalities gains more momentum with increasing multiuse fiber deployments and the commercial rollout of 5G services.

Let's move next to slide 10 to discuss our cash flows. In 2017, cash flow from operations totaled \$25.3 billion, including the \$2.1 billion net after-tax discretionary pension funding and the \$6.0 billion impact from completing the transition to on-balance sheet device payment receivables financing. On a year-over-year basis, our cash flows improved by \$2.5 billion.

As expected, full-year capital expenditures were \$17.2 billion. Free cash flow for the year totaled \$8.1 billion and does not include \$4.3 billion of proceeds from asset-backed securitizations.

The transition to on-balance sheet accounting for device payment plan receivables and funding is now substantially complete. Changes going forward will mostly reflect seasonality in wireless equipment volumes.

We ended the year with \$117.1 billion of total debt comprised of \$108.2 billion of unsecured debt and \$8.9 billion of on-balance sheet securitizations. Our near-term unsecured maturities are modest at \$2.3 billion through the end of 2019. Our balance sheet is strong and provides us the financial flexibility to methodically invest for growth in the business.



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Now let's take a look at 2018 on slide 11. As Lowell mentioned up front, our strategic priorities for 2018 are clear. Our focus is on executing on the fundamentals which positions the business for strong performance in the upcoming year. We expect year-over-year consolidated revenue to grow at low-single digits in 2018 on a GAAP reported basis.

Excluding the impact from the new revenue recognition standard, we are on track to achieve year-over-year wireless service revenue growth by the middle part of 2018. As we disclosed in our January 17 8-K filing, the new revenue standard will negatively impact wireless service revenue. Inclusive of the new standard, we expect wireless service revenue growth to turn positive toward the end of 2018 or early 2019.

The benefits of our business excellence initiative, including the deployment of zero-based budgeting, will begin to show up in our results in 2018. We expect low-single-digit growth in adjusted earnings per share, which includes the dilutive impacts from a full year of depreciation and amortization costs from 2017 acquisitions, the Straight Path acquisition, expected to close later in the first quarter, and the ongoing impact of last year's data center divestitures. This is before the impact of tax reform and the revenue recognition standard.

In terms of tax legislation, we expect the savings to generate a net \$3.5 billion to \$4.0 billion uplift to cash flows from operations in 2018. And it is expected to yield a \$0.55 to \$0.65 increase to EPS in 2018. Net of our employee initiative and contributions to the Verizon Foundation that Lowell mentioned earlier, the resulting 2018 effective tax rate for Verizon is projected to be in the range of 24% to 26%.

Lowell stated earlier that our internal capital decision process and return objectives have not changed. We are consistent and methodical in our allocation. We expect consolidated capital spending to be between \$17.0 billion and \$17.8 billion, including the commercial launch of 5G.

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

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

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Philip Cusick, JPMorgan.

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**Philip Cusick** - *JPMorgan - Analyst*

One for Matt and one for Lowell, if I can. First, Matt, I wonder if you can talk about the Company's target leverage. And is there any change in your thoughts or the discussions with rating agencies on what appropriate EBITDA multiple, when your conversion from EBITDA to cash flow is now substantially better because of lower taxes?

And then Lowell, can you please discuss Verizon's view of the attractiveness of media assets in general? A year ago, you offered a definitive no on any interest in buying big media. And yet, Verizon has been thrown out as a potential buyer in nearly every media M&A story of 2017, which has probably been confusing for your investors. Can you just give us an update? Thanks.

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

Good morning, Phil. I will take the first question there. So the target leverage -- we haven't specified an exact number there. But as we've said consistently, we want to strengthen the balance sheet. The additional proceeds from the benefit of tax reform allow us to get there a little faster.



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The key here is to have a strong balance sheet that allows us to pursue and execute on our strategy as quickly and as efficiently as we can. So as I say, we haven't given an exact leverage target, but you should expect us to deleverage from where we are today.

We said previously getting into the same type of profile that we had prior to the Vodafone transaction. So I think that gives you a general view of the direction we'd like to head.

In terms of the rating agencies, I've not had any specific conversations with them since tax reform happened about how that may change their views. But certainly it gives us the ability to bring the leverage down at a little faster rate. And we look forward to doing that through 2018 and we will continue to have conversations with them and put the balance sheet in a place where it continues to support the business.

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### **Lowell McAdam** - *Verizon Communications Inc. - Chairman and CEO*

And Phil, good morning. I guess my first comment is I guess it's nice to be loved. So there certainly is a lot of interest here, which frankly we ignore. I think in seriousness, there is a lot of movement in this area right now. We don't even know whether AT&T is going to get approved.

It's clear that the messages that Disney and Fox are sending is that scale matters. So we look at this, but you have to take a look at whether being a big independent distributor is a reasonable alternative to owning content. And I think until all of this shakes out, you really can't determine whether that's a path that we'd be interested in.

But I can say unequivocally, there is nothing going on right now with us considering a large media play. In fact, if you look at our actions, things like the NBA and the NFL announcement that we've made in the last few weeks, we think being a great partner, being able to monetize through advertising, and being independent is a very good place to play for us right now. And that's -- until further notice, that is what our investors should assume we are doing.

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### **Philip Cusick** - *JPMorgan - Analyst*

That's helpful. Thanks, Lowell. Thanks, Matt.

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### **Operator**

Simon Flannery, Morgan Stanley.

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

Great. Thank you very much and good morning. And one for Matt and Lowell as well. Matt, can you just help us with the math from Q4 to Q1 around the revenue recognition? You are moving some revenues from service revenues to equipment. And then you should get at least a temporary EBITDA and EPS lift. If you can just give us a little bit more color around what we should be modeling there?

And then, Lowell, you obviously went through the 5G rollout in a lot of detail in November. We are a couple of months past that. Can you give us a little bit more clarity about what we should be expecting for the rest of the year?

When should we see Sacramento launching? What about announcing some of the other cities? How many POPs should we be expecting covered in 2018 and then into 2019?





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

Thanks, Simon. So I will take the first part of that on the adoption of revenue recognition. So a couple of things there. Firstly, we created an opening balance sheet adjustment to reflect some of the treatment of open contracts, assuming they had been recorded under the new standard.

Remember, unlike most adoption of accounting standards, the prior periods are not being recast. And so you will have a little difference between the accounting standard for the 2018 numbers versus the 2017 comparisons you will see there. So as we go through the year and we report 2018 on the new standard, we will also give a view as what 2018 would have looked like if it had been under the old standard as well.

So in terms of breaking those pieces apart, as we said in the 8-K last week, total revenue won't have any significant impact from the change. But there will be a change in geography. We will record more equipment revenue and less service revenue initially based off that change and how we treat contracts that are still subsidized, which is primarily our B2B contracts.

And then the biggest impact to the EBITDA line is going to come from how we treat commissions. And rather than taking those commission expenses and expensing them immediately when they are incurred, they will get spread over the estimated life of the underlying customer contract.

Now, the opening balance sheet adjustment is only for the open contracts that had a 24-month commitment or promo cost. So it doesn't relate to all of the contracts. So that's what you will see a buildup in that over the next two years.

So we said the net benefit in 2018 will be about \$0.9 billion to \$1.2 billion because of the change in accounting standards. Most of that coming from the commissions line. We didn't break it out by quarter, but I think you should expect it not to be too dissimilar from quarter to quarter as we go through the year.

And then the impact in 2018 will be bigger than it will be in 2019 and then it will be largely immaterial by the time we get to 2020. Because that contract asset that builds up on the balance sheet will reach a plateau level where the ins and outs are equal. By the time we get into 2018, they won't be materially different. So hopefully that answers your question on rev rec.

**Lowell McAdam** - Verizon Communications Inc. - Chairman and CEO

And Simon, on 5G. As you indicated, we shared a lot of information in November. The trials are continuing to go extremely well for us. We have more than 200 sites up online. We continue to learn every day.

The distances that we shared and the throughputs are very consistent up to about 2,000 feet, which is much better than we expected. We are doing more testing around throughputs. We are seeing 10 gigabits of peak throughput. So we are very comfortable with being able to deliver a gigabit of service to everyone that we are providing service to.

As you may have seen, the new standard, the global standard, was approved in December. And we have announced with Qualcomm bringing chips online that will fit that standard in the second half of 2018. So we will be deploying with our proprietary standard, but also very, very quickly in 2018, coming on with the global standard as well.

If you saw what was going on at CES, there was a lot of discussion about devices. And we believe that there will be mobile devices late in 2018 and then more available as we get into 2019. If you saw just last week, the FCC approved our purchase of Straight Path and so we are excited about moving that forward to close.

So as far as execution goes and POPs, we are placing the fiber that we need now, as we shared. And I know you were there in November. We shared the number of incremental sites that you need over a densified 4G network is much smaller than we had expected. So we are not seeing the sort of capital intensity that some were assuming.



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So as you indicated, we have announced Sacramento. We have three to five planned for the year. I am personally out meeting with some of the mayors, talking about what we are going to be providing. And the reception has been extremely positive.

So as you know, it takes a little while to work through the city governments and get these things approved, but Sacramento is a terrific model for us. We continue to build that partnership. And I wouldn't suspect it will be too much longer before you will see the other cities announced and then we can be more specific on POPs.

But as far as capital goes, Matt told you what our guidance was for the year. We are reallocating the capital that we have been spending. We don't see any upward pressure of this in this year. And we will be able to determine the return on invested capital as we go through these trials and these commercial launches and we will share more information as the year moves along.

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

Great. Thank you very much.

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**Operator**

John Hodulik, UBS.

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

Thanks, guys. Either for Matt or for Lowell. Can you guys talk about the low-single-digit GAAP earnings guidance, which I assume includes Straight Path and the \$0.05 to \$0.06 from the increase from the charitable contribution?

Talk about some of the underlying drivers of that. You have seen wireless EBITDA margins continue to move up; some pressure on the wireline side. Is that what we can expect for 2018? And talk about how you see the competitive environment evolving in the wireless market that may support continued increase in margins on that side. Thanks.

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

Yes, thanks, John. Good morning. So yes, in the guide, we talked about the low-single-digit GAAP earnings. And we talked about a few below-the-line items in there.

Straight Path will be dilutive because we are largely paying for that transaction in shares. And you will see an uptick in D&A cost because of the transactions we did last year.

But we are confident that the underlying earnings are improving. You are seeing that come through the service revenue on the wireless side of the business. You saw that number improve to just a negative 2.9% in the fourth quarter.

And then we said on an apples-to-apples basis getting back to flat to positive by the middle part of the year. So excited that we have completed that journey of transitioning the base and look forward to continuing to see wireless revenue growth from there.

Wireline I think in 2018 will be on a similar trajectory that you've seen in the past couple of years. Although as we continue to deploy more fiber in the network, it gives us opportunities to replace some of those earnings that were on copper-based products with fiber-based products, which will be more sustainable going forward. So net-net, you should certainly see an improvement in the earnings profile of the Company versus the last couple of years.



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And then you mentioned the charitable contribution in your comment. I want to be clear that the guide is before the impact of tax reform and revenue recognition. And when we say before the impact of tax reform, we also mean the net impact of tax reform, which includes the contribution to the foundation and the employee piece.

So the low-single-digit EPS guide is before that \$0.05 to \$0.06 impact of those couple of initiatives Lowell described, which is baked into that \$0.55 to \$0.65 positive impact from tax reform. So hopefully that gives you a little more clarity on the moving parts within there. But it's built off the underlying earnings profile being stronger year over year.

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**John Hodulik** - UBS - Analyst

Okay, thanks, Matt.

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**Operator**

Brett Feldman, Goldman Sachs.

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**Brett Feldman** - Goldman Sachs - Analyst

Thanks for taking the question. I have sort of two follow-ups here around the impact of tax reform. You talked a bit about how you are going to be taking advantage of some of the benefits you are going to see.

I'm curious if we could expand on that. Do you see an opportunity to maybe reinvest some of the savings in your competitive behavior? Meaning, we've had kind of a calm period here to end the year. You have invested a lot in your business.

Is there an opening here for you to maybe spend a bit more to get customers to revisit your network or even just to get your existing customers to maybe to move into newer devices where they can take advantage of some of your network investments you've been making recently?

And then just also we're kind of hoping that at a broader corporate level you will see a lot of changes in behavior. You obviously have relationships with large enterprises. I know it's early days, but in your discussions with them, are you seeing any green shoots that perhaps they will start increasing investments in their businesses in ways that can maybe have a positive lateral implication for your enterprise services segment down the road? Thanks.

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**Lowell McAdam** - Verizon Communications Inc. - Chairman and CEO

Okay, well, let me start out, Brett, on that and then Matt can certainly add in. On the competitive front -- you've been around me for years. I have said from 1983 when I got involved in telecom and wireless that it's an extremely competitive market. And the competition can come from different places at different times, but it's always very strong.

Verizon has never been one to lead the market down from a price perspective and we are certainly not going to change that now. Our focus inside the business is to use the assets that we have in our portfolio today, like Oath, to be competitive in ways that the others can't compete. And as we roll 5G out, we see much more opportunity to be innovative as a way to be competitive versus using tax reform to just take our prices down.

Now, on your enterprise front, I think we have all been very pleased at how the market and the economy has run up here since tax reform. And just like we are positioning ourselves to be able to execute and accelerate our strategies, I see other businesses doing the same thing.



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And telecom is such an important part of the productivity measures of a lot of these enterprises, we do see the opportunity to pick this up. But remember, we are only 30 days into the tax reform process. And we are all trying to understand the implications on what we can accelerate and how we can accelerate.

So where we build our fiber, where we are deploying 5G, what enterprises are telling us they want to do with our intelligent edge network is influencing where we put our capital dollars. And I expect this to continue and I expect to see things pick up.

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

Great, thank you.

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**Operator**

David Barden, Bank of America.

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

Thanks for taking the questions. Maybe a couple quick clarifications from Matt and one for Lowell. With Matt, so just following up on that EPS guide, to be clear, the low-single-digit guidance does include the benefit from the change in the accounting for the handset-related selling costs. And -- just to clarify that.

And then the second on the cash flow guidance. The \$3.5 billion to \$4 billion cash flow benefit, is that a sequential year-over-year benefit or is that a benefit relative to what you were expecting to pay in cash taxes in 2018?

And then Lowell, if I could just ask. You've done a number of things on fiber, both organic builds in terms of Boston, for instance, acquisitions of XO, and then more creative partnerships like on the WOW front.

Can you talk a little about as we look into 2018, 2019 the path forward on fiber infrastructure and supporting the 5G build? Is it more of an organic game plan from here on out or are there still ways to make acquisitions on that front?

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

Thanks, David. So your second question to me, the cash flow guide, the \$3.5 billion to \$4 billion. That is compared to what our 2018 cash taxes would have been without tax reform. So it's not a comparison against 2017's cash taxes; it's just the 2018 impact with and without tax reform.

On the EPS guide, maybe I will try saying this a little clearer. The EPS guide is our view on the business without revenue recognition and without tax reform. So then you lay on top of that number the impact of revenue recognition that we gave in the 8-K last week. And you also lay on top the \$0.55 to \$0.65 increase in EPS that I described in the prepared remarks earlier this morning. So hopefully that -- does that help clear up the EPS question?

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

Sorry, Matt. It was -- because the revenue recognition is one thing. But there is an expense recognition change that's a separate thing that's a benefit between \$900 million and \$1.2 billion. And I was just wondering if that's included in the single digit or not included in the single digit?



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

It is not included in the single digit. You add it on to the single-digit guidance.

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

Perfect. Thank you.

**Lowell McAdam** - *Verizon Communications Inc. - Chairman and CEO*

Okay, and then David, so your question kind of boils down to is it organic or is it M&A and where do we see deploying fiber. So just for everyone else on the call, we have done some M&A. XO had a fair amount of fiber and WideOpenWest had fiber that we did by M&A.

But we also announced our deal with Corning, which is a multiyear deal where we are doing 12.5 million miles of fiber per year for the next 3 years. So that would tell you we are sort of tilting toward organic.

And our priorities are really what can we do to get off of others' lease services to meet our 4G cell densification needs, then 5G, and then our enterprise customers. We are out in markets now obviously placing fiber, but it's a market-by-market analysis of the three factors that I just talked about.

And frankly, the cities, the meetings that we're having with the cities and what access they will give us to street furniture and conduit and those sorts of things factor into the equation. So it's a bit fluid at this point. And I wouldn't tell you that if an opportunity came up to accelerate it through M&A, we would do it.

But most of the fiber companies were built for different purposes. They were point-to-point enterprise sort of services and they don't fit the architecture that we're building today, which is multiuse fiber for our intelligent edge network. So I hope that's clear enough for you. But certainly leaning toward organic builds to meet Verizon needs to drive our costs down and our performance up.

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

Thanks, guys. I appreciate it.

**Operator**

Michael Rollins, Citi Research.

**Michael Rollins** - *Citigroup - Analyst*

Question for Matt as well as a question for Lowell. First, Matt, can you talk about the strength in wireless phone net adds in the fourth quarter in a bit more detail? And can you also describe what you are seeing from two of the changes in the competitive market over the past 12 months, which is cable starting to sell wireless subscriptions and also some of your competitors bundling in video services.

And Lowell, I was wondering if you could talk a little bit more about the vision at Verizon. As you look at what you are investing in the mobile business, fiber infrastructure, 5G, is there a broader vision inside the Company that you want to provide broadband access to as many premises as well as mobile customers across the country?



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And is there some vision of what proportion of the country you may be able to reach in three to five years as you take all of these things together that you are doing as a Company? Thanks.

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

Thanks, Mike. So I will start off with the wireless phone question and Lowell can get onto fiber. Look, we had a great year on the wireless performance. The net adds were very strong. As I mentioned, our smartphone net adds at 1.8 million for the year, up 34% year over year.

So we really saw a significant change the day we launched unlimited back in February of last year. And from that point forward, we have competed very effectively in the marketplace. And it really allowed customers to have a similar currency to compare different carriers on and the value proposition is resonating.

And despite all the noise that you hear from other people and the claims you hear from other people, the network quality matters. We saw that numerous times throughout the year. And we see that in the performance we had on net adds, whether it be the new activations coming in or the churn that we've had.

So each of the last three quarters of the year, phone churn was below 0.8%. And I think that tells you how much customers enjoy being on the Verizon network.

So you ask about the MSOs. We are happy with what we've seen so far. Obviously, Comcast is on and Charter has said they expect to be on later this year. And as we have said consistently, we like those agreements and we signed them in 2011 and we are happy to be doing them today and we will see how they play out.

But everything we've seen so far is in line with our expectations. And we are glad to have that traffic on our network and monetizing that traffic based on what those companies are doing with those agreements.

And in terms of what the competitors are doing, look, they've bundled a number of things into their services during the course of last year and our numbers have stayed very consistent. So at the end of the day, the quality of the network that the device is on is of fundamental importance.

And overall, when you look at our value proposition, it continues to resonate strongly. And as I say, we are very happy with the results we had last year and starting off 2018 on the front foot.

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**Lowell McAdam** - *Verizon Communications Inc. - Chairman and CEO*

Okay, Mike, let me take where do we want to head from an infrastructure and a vision perspective. Look, I think it's very clear here whether you look at what's going on today with customers or what you are anticipating that you saw at CES and others from what's next that there is an insatiable demand for broadband.

And it's not mobile and it's not fixed. Customers don't care, and I think who wins is going to be able to provide them the service that they can move seamlessly from fixed to mobile. We have been a much stronger mobile company over the years.

But the way we are positioning our fiber deployment and the way we are positioning 5G, we will be able to disregard geography and deploy those broadband services at a much lower cost than we have ever seen at least during my career.

Now, for us, to complete the vision, you need to be able to provide the Internet information services. And video drives an awful lot of that. And we've talked at length about taking the Oath assets to be that information source around news, sports, finance, and entertainment and lifestyle. We think that the assets that we have will provide what customers need.



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And you look at the applications going forward, whether it's medical and healthcare services, whether it's smart cities, whether it's education, whether it's autonomous cars and transportation systems, you are going to need that sort of seamless high-bandwidth. And we lump that under the title Humanability.

So our focus is around giving all of our customers the capabilities to embrace these applications of the future that are going to make their lives so much better. So our investments, they are all about providing the assets and the platforms to deliver that.

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**Michael Rollins** - *Citigroup - Analyst*

Thanks very much.

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**Operator**

Craig Moffett, MoffettNathanson.

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

Hi, good morning. A question about your capital budgeting process in the light of tax reform. Just given that the returns on a whole range of projects will now have been boosted by both the lower tax rate and the accelerated depreciation, does that change your priorities with respect to capital investment?

Or are there some specific types of projects, whether it's deploying fiber or that sort of thing, that now pop to the front of the queue as being meaningfully more attractive than they were? And how should we think about that with respect to the total size of your capital budget going forward?

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**Lowell McAdam** - *Verizon Communications Inc. - Chairman and CEO*

Well, Craig, I'll take that and then Matt can jump in. I guess you could accuse us of being boring, but you at least should give us credit for being consistent. We have been extremely disciplined, and then when we see an opportunity we go hard. And you saw that in 3G, you saw that in 4G, and you are going to see it and you are seeing it in 5G and placing fiber.

We see a real opportunity here. We were the ones that stood up and said two years ago when everybody said we were way too early, but we've been deliberate about it. We have gone out, we have done the field trials, we have developed the ecosystem, we have worked with partners from Korea as well as the infrastructure providers.

We are out there, as I said, with 200 cell sites today learning. And we are going to see what commercially happens in these three to five cities. Then we will make the decision.

So to us, it's very inconsistent that just because tax reform comes through, we are all of a sudden going to draw the line at a different place or lose that discipline. What tax reform does do is gives us great flexibility that once we prove to ourselves that we can get a reasonable return on invested capital, we can accelerate very rapidly. And that gets to Matt's point about we want to early on strengthen that balance sheet to give us the flexibility.

But the strategy is there. We are sort of like a spring ready to expand very quickly if we need to. But we have to get through another couple of hurdles here before we make those decisions. And we are not ready to say that in January of 2018, but I certainly hope by fourth-quarter results next year we are accelerating because we've got such a great story to tell.



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

The only other thing I would add to that, Craig, and I kind of come back to the comments that Hans Vestberg made earlier this month. That in our industry, the nature of the way that we spend money, having significant increases and decreases is inefficient in the way we deploy CapEx.

So we are certainly looking at, given, as you say tax reform, can change some of the return math. But we will be methodical about it. And there is a lot of planning that goes into our capital spending before we get to it.

And so that's why you see us making the comments we do. We certainly look forward to having the right opportunities in front of us, but you will see us do it methodically and do it in the way that creates the greatest value.

**Operator**

Jennifer Fritzsche, Wells Fargo.

**Jennifer Fritzsche** - Wells Fargo Securities, LLC - Analyst

Thank you for taking the question. Two, if I may. One, the inevitable spectrum question. With T-Mobile's purchases and the broadcast auction they have, I think two times the amount of low band spectrum. While you have a ton of millimeter wave spectrum, some naysayers might say that all the eggs are in that basket. How do you think of that?

And then second, if I could get some math around David's question earlier. You mentioned moving away from leases. Can you quantify how much right now you are paying in backhaul to some of the fiber providers?

**Lowell McAdam** - Verizon Communications Inc. - Chairman and CEO

Why don't I take the spectrum question. As you say, Jennifer, the inevitable question. Look, there's going to be an awful lot of noise around deployment of 5G.

If you recall back when we deployed 4G, there was a big scramble for everybody to try to get 3G to look like 4G. And we called it faux G, F-A-U-X, and you are seeing some of the same stuff right now.

In order to do 5G -- and this is right out of the standard, which we certainly agree with -- you need at least 100 megahertz of bandwidth to provide the latency, the reliability, the throughputs that really are the 5G promise. I can take 5G and I can put it on 10 megahertz of PCS if I want to. It won't perform like 5G. It will be the technology, but it won't have the reliability, it won't have the throughput, and it won't have the latency.

So you are going to get a lot of this well, they need this or -- depending on whether you are selling spectrum or what you've got in your basket of spectrum today. But I wouldn't change positions with anybody out there. I have got plenty of low band spectrum. That works great for 4G. It's going to service for years to come.

But in order to put all of the aspects of 5G into play, you need hundreds of megahertz of bandwidth. The only one who has that in a big way in the marketplace is us.

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

So I will just add one other piece to that. I agree exactly what Lowell said about 5G. And as you think about 4G network, we've always said there's three things: it's spectrum, it is the densification in the architecture, and then the technology.





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And I can tell you over the past few months, there's been a number of technology upgrades to the network and you are seeing that in the network performance. A number of those were deployed in the backend of the fourth quarter.

So significant amount of additional capacity being added to the network as we head into 2018. Again, without having to go acquire additional spectrum. But I do expect you to ask that question on most calls going forward. It would be kind of amiss if people didn't.

In terms of your question on how much we pay in backhaul fiber, that's not a number we've disclosed. We really don't break out the income statement by individual line items and we are not going to start doing that now. But I would just say as we think about fiber, we look at the most economic way of getting it, irrespective of where it shows up in the financial statements. And we will continue to do that.

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**Jennifer Fritzsche** - Wells Fargo Securities, LLC - Analyst

Thank you.

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**Operator**

Amir Rozwadowski, Barclays.

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**Amir Rozwadowski** - Barclays Capital - Analyst

Thanks very much. Late last year, Lowell, you had highlighted a goal for \$10 billion in cost cuts over the next few years. I was wondering how should we think about the areas where you believe the biggest opportunities for cost reductions are? And how should we think about those cost cuts filtering in through the Company over the next couple of years?

And then secondly, I was wondering if, going back to the 5G topic, if you can touch upon whether you believe that fiber will be a competitive advantage in this world? Clearly you folks are making a significant amount of investment to get the necessary densification and capillarity that you need for fiber. Others seem to be working with cable providers to improve densification and backhaul.

Do you believe that this is a viable alternative versus what you guys are doing? Or do you believe that at this point in time you are setting the stage for a longer-term competitive moat as 5G comes to commercial positioning?

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

Thanks, Amir. Let me take the first one on the \$10 billion number over the next 4 years that Lowell mentioned in September. And we've talked about it a little since then.

Look, every area of the business is where we are looking and we believe that there's opportunities across every area of the business. Obviously, network costs are a significant part; distribution is something we're taking a close look at. Customer care, all the back-office type activities.

Essentially there is no area of the business that isn't going to get examined as part of this exercise. Because it's imperative we make sure that we are as efficient a Company as we can be as we go forward.

From a timing standpoint, I can tell you we've embedded the 2018 targets for this activity in each of the business units' operating plans for the year. And I look forward to discussing the results that we achieve on this as we go forward in 2018 and into the future.



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### **Lowell McAdam** - Verizon Communications Inc. - Chairman and CEO

And then, Amir, I guess my answer on the fiber competitive advantage is throughout my career, I've always believed and it's been reinforced many times that if you've got a critical component of your success, you better own it and control it.

And that fits with our direct distribution. It fits with a lot of our customer service. We don't outsource sales. We certainly wouldn't outsource critical components of our network.

As Hans has come in and put in our architecture for intelligent edge, owning that fiber asset is important to our financial performance as well as the performance of the network. And as we have seen time and time again, network competitive advantage drives customers, which ultimately drives financials.

So you won't see us outsource much in the way of network unless someone has a huge scale advantage and we could negotiate very strong performance and very consistent financials that would go along with it.

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

Thank you very much for the incremental color.

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

That's all the time we have for questions. Before we end the call, I'd like to turn it back over to Lowell for some closing comments.

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### **Lowell McAdam** - Verizon Communications Inc. - Chairman and CEO

Thanks, Brady. So just a couple of final points from me. I don't come on these calls very often. I like to save that for when we've got significant changes in the business. And obviously tax reform and our use of those funds was important for us to clarify.

But there was a second reason for me to come on. And I have been in this industry for 30 years and I think we are breaking into one of the most exciting times that I've seen in my career. We are on the cusp of what I call the Fourth Industrial Revolution as we see smart city applications, the changes in medical, the changes in transportation and education. All of those are fueled by a strong telecommunications infrastructure. So I think this is a great time for our industry overall.

Obviously, I think Verizon is the best positioned to deliver that future. We've had a long history of strong operational and financial performance. We are investing in the media platforms and the fiber assets and the network and in the new technologies to meet the needs that are coming forward. And I think, as I said, that will be a major change in the way people live, work, and play.

So I'm very excited about 2018, what lies ahead for us. I look forward to sharing the results and the successes as we move forward in this year. And coming on a call next year at this time and recapping one of the best years in our history. So with that, we will close the call and we appreciate all of 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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