Verizon Communications Inc. (VZ) CEO Discusses Q2 2013 Results - Earnings Call Transcript

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Verizon Communications Inc. (VZ) Q2 2013 Earnings Call July 18, 2013 8:30 AM ET

Operator

Michael Stefanski

Good morning and welcome to the Verizon second quarter 2013 earnings conference call. [Operator instructions.] It is now my pleasure to turn the call over to your host, Mr. Michael Stefanski, senior vice president, investor relations.

Michael Stefanski

Thanks, operator. Good morning, and welcome to our second quarter 2013 earnings conference call. This is Mike Stefanski, and I'm here with our chief financial officer, Fran Shammo. Thank you for joining us this morning

Before we get started, let me remind you that our earnings release, financial and operating information, the investor quarterly, and the presentation slides are available on our Investor Relations website. Replays and a transcript of this call will be available on our website later today.

I would also like to draw your attention to our safe harbor statement. 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 also 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 also available on our website.

Before Fran takes you through the details, I would like to make you aware of a non-operational item included in the quarterly results. For the second quarter, we reported earnings of $0.78 per share on a GAAP basis. These results include $147 million after tax, or $0.05, for the favorable effect of an interim actuarial remeasurement associated with one of our pension plans, due to settlement accounting.

The noncash credits were due primarily to an increase in the discount rate assumption used to determine our current pension liability. On an adjusted basis, EPS was $0.73, compared with $0.64 a year ago.

Our discussion of consolidated results and growth rates in this presentation exclude the effect of the nonoperational gain. In addition, the quarterly growth rates disclosed in this presentation are on a year-over-year basis, unless otherwise noted as sequential.

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

Fran Shammo

Thanks, Mike. Good morning everyone. Our strategic investments in 4G LTE, FiOS, global IP, and cloud services continue to drive strong operating performance. We are executing well in these key growth areas.

Overall, consistent top line growth, along a strong focus on cost efficiency and profitably, resulted in double-digit growth in operating income and earnings per share in the second quarter. In fact, we have posted double digit earnings growth in five of the last six quarters.

Second quarter adjusted EPS was $0.73, up 14.1%. Year to date, adjusted earnings per share were $1.41, representing 14.6% growth. As you know, our strategy focus is on building networks and platforms as the foundation for innovation and growth.

Underpinning our success is the consistent investment in these networks and platforms, which position us to take advantage of growth opportunities in the rapidly evolving wireless and wireline markets for broadband, video, and cloud services.

Operationally, we are focused on increasing value by delivering products and services to customers in the most efficient and effective way possible. In wireless, our Share Everything plans are a great example. We have simplified decisions for customers, making it easy to add new devices and manage their shared data usage.

Our FiOS Quantum offer, where customers can upgrade broadband speeds themselves, is another example of improving service quality and increasing operational efficiency. Throughout the entire business, there are many examples where Verizon Lean Six Sigma principles are being adopted, and we are realizing efficiency gains in a number of areas, including customer care, supply chain, and system support.

As we move through the year, we are confident that successful execution in our key strategic areas will continue to drive incremental revenue and promote operating efficiency, resulting in sustainable growth in free cash flow and earnings.

Let me shift now to our second quarter performance, hitting a few highlights. Our wireless results were strong, once again effectively balancing growth and profitability. We added 941,000 retail post-paid connections, up nearly 40% sequentially. Service revenue grew more than 8%, EBITDA growth was up double digits, and our EBITDA service margin was 49.8%, solidly within our annual margin guidance.

We also had a strong quarter of customer and revenue growth in FiOS. Revenues were up nearly 15%, and we added 161,000 new subscribers in FiOS internet and 140,000 in FiOS video, roughly 20% more than we added in the second quarter last year.

In global enterprise, strategic services revenue grew 4.8%. Our consistent operating performance, together with disciplined capital spending, is driving higher free cash flow. Through the first half of the year, free cash flow increased by more than 20%, resulting in an improving return on investment profile for the entire business.

Now let's take a brief look at consolidated results, starting with slide four. Total operating revenue grew 4.3%, sustaining our solid top line growth performance. For the quarter, the increase in consolidated revenues, coupled with effective cost management, resulted in 11.8% growth in adjusted operating income.

On an adjusted basis, consolidated EBITDA increased to $10.5 billion, and our EBITDA margin expanded by 90 basis points to 35.1%. Now let's move into a review of the segments, starting with wireless on slide five.

We have emphasized that consistent investment in wireless drives our leadership in network quality, reliability, and the overall customer experience. Our commitment to 4G LTE covers a wide range of activities, including the securing of necessary spectrum, the allocation and deployment of capital for both coverage and capacity, our leadership in fostering a robust device and application ecosystem, and the success of our Share Everything plans in driving device adoption and stimulating usage.

Once again, our second quarter wireless results demonstrate the effective execution of this strategy. Total wireless revenues grew to $20 billion, representing 67% of Verizon's consolidated revenue. We sustained strong service revenue growth of 8.3%, making it the third consecutive quarter of growth in excess of 8%. EBITDA increased to $8.5 billion, and our EBITDA service margin expanded by 80 basis points year over year to 49.8%, representing another very strong quarter of growth and profitably.

Let's now turn to a more detailed look at wireless revenue per account, beginning on slide six. Service revenue growth continues to be driven by increasing connections, smartphone penetration gains, and data usage. The simplicity and value proposition of our Share Everything plans is driving device adoption and stimulating higher usage, resulting in increases in both the number of devices and revenue per account.

During the second quarter, retail post-paid service revenue per account, or RPA, grew 6.4% to $152.50 per month. We have 35 million post-paid accounts, and the average connection per account increased to 2.7, up 5.5%.

Our Share Everything plans have been very successful. The plans have been available since June 28 of last year, and customer adoption has been very strong. In just one year, more than 36% of our post-paid accounts are on a Share Everything plan. The value proposition is simple and straightforward, and customers increasingly recognize the value of shared data across multiple devices.

Let's take a closer look at connections growth on slide 7. As I highlighted earlier, we added 941,000 new retail post-paid connections, up from 677,000 in the first quarter, and about 6% higher than a year ago. We also added 97,000 retail prepaid connections, so our retail net connections totaled just over 1 million in the quarter.

As I stated on our last earnings call, we expect to continue to see sequential quarterly net add improvement in 2013. Total retail connections topped the 100 million mark in the quarter. Our industry-leading post-paid base stood at 94.3 million, and we have more than 5.8 million prepaid connections.

Our connections growth was driven by another strong quarter of gross additions. Postpaid gross adds of 3.6 million were up 14.2% year over year. The number of customer upgrades also increased by sequentially and year over year, with a postpaid upgrade rate of 7% for the quarter. We continue to expect that our annual upgrade rate will be about the same as last year. Our upgrades remain high quality, with 36% of customers purchasing a smartphone for the first time.

We also maintained a high quality mix within our postpaid net adds. We added 472,000 in the phone category. Of this total, 974,000 were smartphones, with the balance representing the decline in basic phones. We added 371,000 internet devices, including tablets. The balance of just below 100,000 included Home Phone Connect, Home Fusion, and other connected devices.

Our churn metrics continue to be market-leading. Retail postpaid churn was 0.93%. The sequential improvement was due primarily to an expected reduction in involuntary churn, as discussed coming out of the first quarter.

Next, let's turn to slide eight and take a look at device sales and our progress in 4G LTE. Postpaid device activations totaled 10.1 million in the quarter, representing both a sequential and year over year increase. We had a high quality device mix once again, with 88% of the activations being phones.

Smartphone activations totaled 7.5 million, and 72% of them were 4G LTE. The smartphone mix was fairly balanced;

roughly 51% of the activations were iPhones. Our smartphone penetration continued to improve, and we ended the quarter at over 64%. We had another strong quarter for internet devices. Activations of these devices, which include mobile hotspots, jet packs, and tablets, topped 1 million again this quarter.

Adoption of 4G LTE smartphones and devices continued to accelerate. One-third of our retail postpaid connections are now 4G LTE, compared to just 12% one year ago. 46% of our smartphones, and more than two-thirds of our internet devices are 4G LTE. Currently, 59% of our total data traffic is carried on the 4G LTE network, which is five times more efficient than the 3G network.

In terms of geographic coverage, we now cover 500 U.S. markets with 4G LTE, and have essentially completed our buildout by matching our 3G footprint. Our LTE network covers more than 99% of our 3G footprint, and when you include our rural America partners, LTE is available to about 301 million across the nation.

Throughout the rest of this year, we will continue to invest, adding capacity to our existing 4G coverage, ensuring that customers are receiving the quality and consistent reliability that they expect from our network and devices. I will cover our capital spending outlook in more detail during our discussion of cash flows.

Let's move next to our wireline segment, starting on slide nine. Our wireline investments and platforms, such as FiOS, global IP, security, cloud services, and machine-to-machine, enable us to deliver the services and leading-edge applications and solutions that customers want. As these services scale, they will become increasingly efficient, and will help improve our cost structure in the long run.

Total wireline revenues decreased 2% in the second quarter, as growth in FiOS and strategic services were offset by softer global enterprise and wholesale revenue from legacy transport services and CPE.

In terms of wireline segment margin, second quarter EBITDA increased to $2.2 billion, and the margin was 22.2%, up 80 basis points sequentially. We continue to believe we can improve the wireline segment margin in 2014. Let's take a closer look at the revenue components, starting on slide 10.

In the consumer and mass markets business, we continue to see positive signs, highlighted by sustained FiOS revenue growth. Consumer revenues grew 4.7%, driven by FiOS, which now represents 71% of consumer revenue. Our overall consumer monthly RPU increased 9.4% to more than $109, and we sustained a blended FiOS RPU at over $150 per month.

Two-thirds of our FiOS customers are triple play, which have a higher amount of recurring revenue per month. As I highlighted earlier, we had a good quarter of FiOS customer growth. In terms of broadband, we had 161,000 new FiOS internet additions and now have 5.8 million subscribers, representing penetration of 39%.

Overall, net broadband subscribers were a positive 45,000. In FiOS video, we added 140,000 new subscribers in the quarter, bringing our total to 5 million, which is over 34% penetration.

In addition to the customer growth and increased penetration, we are also gaining traction with our FiOS Quantum offers for higher broadband speeds. Sales of our FiOS internet product, at speeds in excess of 50 MB per second, increased during the quarter, and existing customers continue to buy up in the speed. At the end of the quarter, one-third of FiOS internet customers subscribed to Quantum, with speeds ranging from 50 to 300 MB per second.

We continue to make steady progress with copper migrations, increasing the number of service upgrades each quarter. During the second quarter, we converted more than 86,000 customers. Through the first half, our total was 169,000, so we are more than halfway to our target of 300,000 for the year.

This network evolution initiative is important for us as we reduce our dependency on older technologies. Aside from the maintenance expense savings, and improvements in customer satisfaction, conversions to fiber also provide customers the opportunity to purchase FiOS services, which could result in additional RPU over time.

Another positive result in the quarter was the steady improvement in our residential connection trends. Retail residential connections declined by 5.2%, compared with a loss of 6.6% at this time last year. We expect that continued strength of FiOS, the copper migration initiative, and the benefits of labor contracts and work rule flexibility will have a positive effect on wireline profitably this year.

Let's move to our enterprise markets next, on slide 11. In the second quarter, global enterprise revenue declined $184 million, or 4.8%. CPE sales, which were down 34% year over year, represented $162 million of the decrease. Excluding the decline in CPE, global enterprise revenue was down less than 1% on a year over year basis.

Strategic services, which now comprise 57% of enterprise revenue, grew 4.8%. In the second quarter, the continued decline in legacy transport services more than offset the growth in strategic services.

We continue to work through economic challenges in the enterprise space. Many of our customers are focused on improving their cost structure, which can result in reduced services with us. In addition, many customers continue to be cautious regarding new investment decisions.

Moving next to global wholesale, quarterly revenues declined $141 million, or 7.7%, due primarily to continued declines in the transport services. Again, our strategy is to better monetize our global IP and fiber network by driving a more efficient migration to next-generation Ethernet services.

In terms of profitably, while growth in the enterprise strategic services is improving the revenue mix, volume declines in the rest of global enterprise and wholesale continue to put pressure on wireline margins. Through our Verizon Lean Six Sigma program, we are making good progress in our cost restructuring programs and retooling efforts, which we believe will improve our operating efficiency.

Let’s turn to slide 12 for a discussion of our cash flow results. Our cash generation remained very strong. For the first half of this year, cash flows from operations increased by 12%. Free cash flow was up by more than 21%.

Capital expenditures for the quarter totaled $4 billion and were $7.6 billion year to date, up 2.5%. Wireless capital spending in the second quarter totaled $2.3 billion. Through the first half, wireless capex totaled $4.3 billion, 8.6% higher than last year.

As I noted earlier, we have essentially completed our initial LTE buildout by matching our 3G footprint. Throughout the rest of the year, we will continue to invest by adding capacity to our existing coverage as we begin to deploy AWS spectrum throughout the network.

In wireline, capital expenditures totaled $1.5 billion in the quarter and $2.9 billion year to date, which was down 5.9% from last year. Strong connections growth, driven by 4G LTE, and our Share Everything plans, has resulted in higher demand forecasts and a need for increased capital investment.

As such, we are increasing our full year capital spending outlook from flat at $16.2 billion to between $16.4 billion and $16.6 billion. We remain focused on improving investment returns and capital efficiency, and we continue to expect our capex to revenue ratio for the full year to improve, even with the additional investments in 4G LTE.

Our balance sheet and credit metrics remain very strong. Total debt at the end of the second quarter was just under $50 billion, and our net debt to adjusted EBITDA ratio was about 1.2x. Let’s summarize on slide 13.

Our second quarter results showed consistently good performance in the key strategic growth areas, so at the halfway point, the key year to date financial and operating metrics are strong: consolidated revenue growth of 4.2%; operating income up 15.6%; adjusted earnings of $1.41 per share, representing 14.6% growth.

In wireless, service revenue growth up a very strong 8.4%; average revenue per account up 6.7%; retail post-paid additions of 1.6 million, up 16.5%; EBITDA growth of 14%, and an EBITDA service margin of 50.1%. We are on track to deliver on our 49-50% margin guidance for the full year.

In wireline, consumer revenue growth of 4.5%, driven by FiOS growth of nearly 15%, 349,000 subscribers in FiOS internet, and 309,000 in FiOS video. We are on track to meet our 600,000-plus FiOS customer growth target.

Free cash flow generation is up better than 20% year over year, and our balance sheet remains very strong. All in all, a very good first half. We are now focused on continuing the momentum, which should result in a strong second half of the year.

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

Michael Stefanski

Fran, thank you. Operator, we’re now ready to take questions.

Question-and-Answer Session

Operator

[Operator instructions.] Our first question comes from Phil Cusick with JPMorgan. Please go ahead with your question.

Phil Cusick - JPMorgan

Two around wireless. First, you talked about sequential improvements in adds in the third and fourth quarter. Given that Sprint's not going to be seeding a number of items into the market, in what's traditionally not a strong third quarter, can you help us see why you're more confident there?

And second, can you talk about how you expect margins to track through the remainder of this year? Given the upgrade comment you just made about being flat year over year, that's a little higher than I would have thought given the commentary, or the change for the fourth quarter. Can you just talk about those?

Fran Shammo

On the sequential third and fourth quarter, it's similar to the trend that we saw last year when coming out of the first and second quarter. We said we would sequentially continue to see growth in the third and fourth quarter. And again, this is around what we expect the roadmap to be on additional device launches throughout the third and fourth quarter.

But the momentum that we have, and you see that momentum coming out of second quarter, and I'll talk more to that in a second when we get to the margins, we continue to see this high-quality subscriber coming onto the wireless 4G LTE network, and we don't see that changing at this point.

From a Sprint and porting ratio, I won't get into specific individual carriers, but again, pretty consistently positive with all carriers from a porting ratio perspective.

On the margin side of the house, I think we have to put this in perspective. Again, we are fully engaged on the 49-50% guidance that I gave to you in the beginning of the year , and if you look at the first half of the year at 50.1% for the first half and coming out of this quarter at 49.8%.

And I think you have to look at what's behind that. So if you look at, on a year over year basis, just between the quarters, we improved our profitably by 80 basis points. In that, if you look at that, we moved 7.5 million smartphones. 1.6 million of that was additional smartphones over last year. And then if you just look at the 4G devices, we moved 3.1 million more 4G devices this year than we did a year ago.

And in that, if you look at the service revenue growth of 8.3%, that's up 100 basis points over where we were last year. So you can see the quality of these adds, and if you take what we added in the quarter of nets, with 472,000 net phone, it's a pretty good indication of what we're going to drive from a margin perspective.

And then if you look at the network side of this, with 4G LTE, we now have 33% of our customers on that network, 36% of our customers on shared. We had a growth of 5.5% in the connected devices. And I've said that our growth is really dependent on two things. Number one, the 4G LTE network, and as people move over there, the usage of stimulation drives them into higher tiers from a tier perspective on the shared plan.

And then of course the second piece is, as they get on the shared plan, they start to connect all these additional devices. And you can see that with the continued momentum of our internet category and some other things that will be coming to market similar to what we did in the fourth quarter last year as for the camera.

So, combination of all these. I am very confident that we will continue on the margin track that we set out at the beginning of the year.

Operator

Our next question comes from Jason Armstrong of Goldman Sachs. Your line is open.

Jason Armstrong - Goldman Sachs

Fran, there's been obviously some buzz around Verizon investing in Canada. Maybe you can help us in terms of where you see the opportunity. Is this tied into a roaming footprint? Is it tied to maybe serving your own enterprise customer base? Or is there sort of a consumer retail presence you might have in mind tied to this?

And then second question, on FiOS, very good volumes in what's generally a seasonally weak quarter. You talked about the 600 plus, that it seems like you have the opportunity to maybe be meaningfully above that result. I'm just wondering, does what you've seen in Q2 give you the opportunity to maybe set the bar higher for the year?

Fran Shammo

On Canada, again, let me emphasize this is really an exploratory exercise for us. As you all know, they've delayed their spectrum auction until January.

So, again, we continue to just look at this market. I think it's everything that you said that we're kind of looking at. If you look at the population of Canada, about 70% of that population is between Toronto and Quebec. That's adjacent to the Verizon Wireless properties. Again, if you look at the spectrum auction, it mirrors up exactly what we launched here in the United States on the 700 MHz contiguous footprint.

So we're looking at all these, but obviously some of the cautions here are the regulatory environment, a foreign investor coming into the Canadian market and what does that mean? So again, cautiously looking at it. Not ready to make any announcements today. And we continue to explore and have discussions, but at this point it's just really an exploratory exercise.

On the FiOS volumes, again we put a lot of effort around continuing the superiority of the FiOS product. Bobby and his team have done a great job in and around the FiOS Quantum offers and a lot of the stimulated growth that we see here is coming from the Quantum offers that we have, and upgrading those Quantum offers to the 50 and 70 MB per second services.

So look, we set a target for 600,000. Obviously if we can exceed that target, we will. We're ahead of that target, but I will tell you that the third quarter, again, is always a seasonally challenging quarter for us from a move perspective. So let's continue on the track that we are, and if we can overdeliver, we will, but we've set the target at 600,000.

Operator

Our next question comes from John Hodulik of UBS. Your line is open.

John Hodulik - UBS

Quick question on wireline and then wireless. First, on wireline, Fran, in your prepared remarks you mentioned a couple of issues driving wireline profitability, that you see some improvement. I just wanted to see if I could get a little clarification. Are you talking about the year over year trends for the whole year? Or just the second half? If you could just sort of fill in the blanks for us, that would be great.

And then secondly, on the wireless capex increase, can you just talk a little bit about what's driving that? Is it more 4G devices? Is it more usage per device? Or is it maybe the competitive environment and what you're seeing from other carriers? What's really driving the change there?

Fran Shammo

So in wireline possibility, look, we set the bar that said our margin would be flat year over year. Going into obviously in the third and fourth quarters of last year, compared to what we think we can do this year, and coming out of the second quarter, I think in the back half I have to improve the profitability in order to continue to make that guidance that we set out at the beginning of the year that said we would be flat on a margin basis. So I think we're on course to do that, and mathematically, the profit has to get better in the back half of the year in order to sustain that guidance.

As far as the capex on wireless goes, there's a couple of things here that are driving this. If you look at, over the last three quarters, the growth that we've had, the number of 4G devices we've moved, and if you look at just the first half of this year versus the first half of last year, we've added 6.2 million more 4G devices on the 4G network than we had a year ago, from just an overall sale perspective.

So when you look at that and you look at the usage, currently 59% of the data traffic is now running on the 4G network. And that's being driven by 33% of the base. So again, from just a growth perspective on the top line, we've always said, again, that as customers move into shared, and they realize the viability and speeds, and the consistency of this 4G network, it's going to drive them to use higher usage. And if you look at where video's going in the future, obviously that's going to continue the proliferation of the usage on this network.

And we look out two years ahead of where we think our curve is going to be, and given the past success we've had, and the usage patterns, and the amount of 4G devices that we've already moved, and the roadmap that we see coming, we need to accelerate really the capacity that we previously thought. And it's really all to drive what customers want.

So the incremental investment will more than pay for itself on top line growth, from what I see. And again, this is really a shift in our capital discipline between wireline and wireless. And we're going to maintain our lead on the most reliable, consistent 4G LTE network. So that's what's driving the increase for the capex.

Operator

Our next question comes from Simon Flannery of Morgan Stanley. Your line is open.

Simon Flannery - Morgan Stanley

Other wireless service revenues were very strong, up about 20% year over year. I imagine you've got some MBNOs and maybe roaming and other stuff. Perhaps you could just comment on the drivers of that and the sustainability of that.

And then on the enterprise side, you talked about continued cautious behavior and cost focus. Do you see any signs of a second half pickup? I think there's some better news on unemployment and generally macro trends improving in the second half. Are you seeing any of that? Or is it pretty much static from your point of view?

Fran Shammo

On the other wireless revenue, obviously what's included in that other wireless revenue is our reseller base. I don't like to refer to them as MBNOs. That's a bad word for me. But on the reseller base, it's really driven from the prepaid providers that we have on that side of the business.

And again, coming out of this quarter, we did a fairly substantial number of net adds there. And again, our prepay strategy is between what we sell on the retail side under our own brand, and we had a positive quarter again this quarter, with 97,000 net adds.

But we also drive the, if you want, the lower-end market through resellers, and mainly through the relationship with Walmart, through Tracfone. So that drives a lot of volume, and that has been good revenue growth for us.

The other things I would tell you, though, is that in addition to that, obviously roaming is in there, machine-to-machine , which we don't really talk about much. We're gaining a lot of momentum around machine-to-machine, and that is driving incremental revenue, albeit very low individual unit per subscriber type revenues, but again, as we start to gain momentum and sell hundreds and hundreds of thousands of these types of devices, that's going to contribute to those revenues and contribute to the overall growth of wireless. So that's the component of that.

On the enterprise side, look, I understand the unemployment is there, but it's not large enough and steady enough to give me confidence that something's going to turn here in the near future. And again, if you look at the enterprise space, mainly what everybody is focused on is cutting their costs.

And obviously when we talk about cutting costs in enterprise, they come to us and figure out how they can reduce their spend with Verizon and have us give them solutions that help them reduce their spend. And of course we're happy to do that, but it does cause some top line pressure.

And also, I think, again, the uncertainty of what's going on around the government sector, is twofold. Number one, a lot of this pressure in enterprise this quarter, if you look at the decline of 4.8%, over 60% of that was in the government sector for us this quarter. So there is a big impact from the sequestering activity and the pullback from both the state and local governments, and also within the federal government.

As I look forward, though, the uncertainty around this tax situation, and if you think about it, we're now midway through the year, it's highly unlikely that we'll get tax reform this year. So again, we're faced with another cliff at the end of the year if congress does not extend the tax provisions that are currently on the books for another year.

So hopefully they'll do that soon and put some of the uncertainty to rest, at least until the next 18 months, until we can get to all the difficult issues around tax reform, which as you know we have a lot of subgroups working in Washington to help and give suggestions on how to get this done. But that's going to take some time.

Again, it's hard for companies to say we're going to invest in new technologies and new things, when we're not certain what the future of the tax laws hold for the books and records. So I still don't think anything's going to change drastically from where we are. And as I said before, at least from where I sit, the best we can hope for is a flat performance, and if you take CPE out of the equation this quarter, we're at a [0.8%] decline. So that's probably about where we'll be, zero to slightly decline, or slightly positive is kind of where I'm at at this point in time.

Operator

Our next question comes from Michael Rollins of Citi Investment Research. Your line is open.

Michael Rollins - Citi Investment Research

Could you just give us the update on the net debt calculation for Verizon Wireless? And then with respect to the business, I think the metrics that you threw out there on the LTE network implies about 1.8 more usage on the LTE network versus the 3G network. And I was wondering if you could expand on that a little bit more, and maybe give us a sense of what the usage trends are for your customers. And as they move into the shared data plans, if you could give us a sense of that kind of stimulus that you're seeing on the consumption front.

Fran Shammo

On the update of the net debt for wireless growth, that is $10.1 billion, and net debt is $9.7 billion. And as you know, we did a distribution at the end of June of a total of $7 billion out of the partnership to both of the owners. And also, just to keep in focus here, we have about $1.5 billion of wireless debt coming due in the fourth quarter of this year and another approximately $3.5 billion coming due in the first quarter of next year, and we plan to pay that debt off at that point in time.

On the LTE network, you're right on. Obviously what's happening is as people come from the 3G network over to the 4G network, you can see that incremental usage, whether it's a smartphone or a jet pack or a dongle. And as they start to share all this data, the video consumption is increasing year over year and quarter over quarter.

Others in the industry have put out their projections of usage over the 4G data, if you look at some of the things that people have printed, and the escalation that the future holds from a data consumption standpoint as we start to move into more symmetry between in the home and out of the home content. We don't see that slowing, so again, yes, we do see an incredible jump when someone moves from 3G to 4G and the usage that they have on their smartphones and other devices. So that's what's driving the growth.

Operator

Our next question comes from Mike McCormack of Nomura. Your line is open.

Mike McCormack - Nomura

Maybe just a comment on wireless margin. I know you've got the sort of 49-50% expectation for the full year. Last year the fourth quarter had very high volumes that sort of really dragged down margins a bit. Are you getting comfort that the new upgrade policy should have a muting impact on that? And then just secondly, on FiOS competition, maybe just some comments regarding the triple play pricing environment out there, and also how well you're doing in the [MDU] market.

Fran Shammo

On the wireless margins, obviously, again, we're very confident around the 49-50%. As far as the fourth quarter of last year, you have to keep in mind it was the first quarter that there was a free iPhone on the Verizon Wireless network, and we won't have that repeated this fourth quarter. Now, that's not to say that we don't see increasing volume. And again, I continue to say that we'll see incremental net adds through the third and into the fourth quarter.

But from a margin perspective, if you look at just year over year and the amount of volume we've moved, we actually ate through all that volume and improved the profitability of this business. And that goes into managing the entire business.

So from an upgrade policy standpoint, some other things that we'll be launching. You probably saw Verizon Edge and some other options that we'll have on payment plans for our customers to acquire a smartphone. All of these things considered, we are very, very positive on the margin progress and the profitability progress of Verizon Wireless and the continued growth of Verizon Wireless.

Mike McCormack - Nomura

Just on the Edge comment, is that something that you're hearing your customers actually demanding, the sort of equipment financing option?

Fran Shammo

If you look back, we were the first carrier to launch LTE technology, we were the first ones to launch the shared pricing around LTE technology. We launched in the fourth quarter of last year an installment pay plan on tablets. That was something that our customers were asking for. We delivered that to them.

And at that point in time, we started to look at it, and I said we were looking at other options for smartphones. We've done a lot of focus groups in the last six months. We've done a lot of market research. And yes, our customers are asking for another option.

Twofold: Number one, we have a lot of customers on the technology edge that want to be able to upgrade sooner than they would under our historical legacy subsidy model, if you will. And we have other customers who quite honestly don't want to pay up front for the large cost of the phone. They'd rather pay over time.

So I'm not going to get into all the details of Verizon Edge, I'll let Wireless do that, but that's something that our customers have been asking for, and I think we have a differentiated plan to launch to the market and Verizon Wireless will have more to say on that.

Going back to your other question on triple play and MDU, obviously we continue to gain momentum here. Look, this business has always been competitive around the triple play, but I think what's differentiating us right now is the superiority of our product with fiber into the home.

And as you get that fiber into the home, I think what customers are realizing, and we see this with the copper to fiber migration, when they move, and they see the speed that they can get on their internet capacity, we're seeing customers upgrade.

And what I've said is we're seeing our legacy copper customers, who we have migrated over to the FiOS network, they are paying between $10 and $15 more in RPU a month after about 60 days on our network, because they're upgrading freely into that 30 and 50 MB per second.

So that's really what's differentiating us in the market. We will continue to advertise around that superiority, and I think that momentum will carry us into the third and fourth quarters.

Mike McCormack - Nomura

Just a quick follow up on the FiOS side. Is there a point at which you guys are going to migrate to an all-IP video network?

Fran Shammo

Obviously we've already started that with the copper to fiber migration, but that's going to be quite some time in order to deactivate the copper switches and take all that plant and equipment out. We have the plans to do that, but that's not something that's going to be done within this year or next year.

Operator

Our next question comes from Jennifer Fritzsche of Wells Fargo. Your line is open.

Jennifer Fritzsche - Wells Fargo

I did want to ask about prepay. With AT&T doing [AIO] and now with Leap's purchase and Cricket in the fold, and T-Mobile and Sprint obviously having their own brands, is there any interest on your part in launching an independent prepay brand under Verizon, separate from Verizon?

Fran Shammo

I think from a prepay perspective, we are very happy with how we approach this market, between our own prepaid product, which obviously you've heard me talk about in the past, which is just strictly on our 3G network. We do not offer prepaid on the 4G LTE network.

And as I said, we will become more aggressive over time in the prepaid market on that 3G network. Because again, as we look at the 3G versus the 4G, and we move 3G customers into our 4G network, we want to make sure that we keep that 3G network as full as possible, because when you think from an investment return, we're not investing any more in that network, and the fuller we can keep that network without detrimenting the service, the contribution margin of that network is very, very high.

So prepaid is really the pillar of how we will continue to utilize that 3G network, so you'll see us become more aggressive around that when we need to be. You saw us change some pricing in the last two quarters around prepaid, and that has stimulated some growth for us.

And then as I said previously, our other path is through resellers for the lower end market. I don't see the need, at this point, to do a secondary brand around the Verizon Wireless network. We have built our brand around the quality, the reliability, a superior network. I don't think that a secondary brand helps our overall brand at that point.

The other thing I'll say is I'm not going to comment on anything around the AT&T deal with Leap, but I will put to bed the rumors out there that Verizon Wireless may be interested in that asset. And [hear me], we're not interested in that asset.

Operator

Our next question comes from Brett Feldman with Deutsche Bank. Your line is open.

Brett Feldman - Deutsche Bank

I'm not going to ask you about Leap, but that deal is spectrum-driven, and you guys have indicated that you're starting to deploy your AWS-1 spectrum, and maybe that's happening a little sooner than we thought, although you're seeing network traffic ramp very quickly.

I'm just curious if you can maybe give us a status update on your spectrum portfolio. Do you still feel like you have sufficient spectrum to get to the next auction? Do you still see an opportunity to buy spectrum in the market right now from other carriers? And have you started to think about maybe some supplemental solutions, for example maybe revisiting wifi, as another way to put capacity into your network?

Fran Shammo

Around spectrum, we did our AWS deal last year, and that put us in a very good spot for our 4G LTE strategy. We started to launch AWS last year. We started to preposition that. We are accelerating the positioning of the AWS based on my comments before around the usage around wireless. But again, we are very comfortable with our spectrum holdings, and we are in good shape for three to four years.

Obviously we will participate in the auction with the FCC targeted for 2014 around the broadcast licenses. That's something that we will participate in. But we are not under any spectrum pressure.

If you look at our frequencies, and the way we deployed our CDMA spectrum, we can actually take very small slivers out of that CDMA spectrum and reallocate that to our 4G LTE spectrum on a needed basis. And that's where we get into this balancing act between the 3G network and the 4G network.

But we are very satisfied with our holdings for the next three to four years. Obviously we're always opportunistic in spectrum acquisition, and we do actually buy spectrum every quarter. You probably don't see it, because we do little markets here and there.

But look, we're always opportunistic, but at this point, we're satisfied, and there's nothing out there at this point other than the auction that we're concentrating on.

Brett Feldman - Deutsche Bank

And on wifi, anything new there maybe involving your cable partners?

Fran Shammo

From a wifi perspective, obviously we always like people to offload when they're in their home on a secured wifi network. You've heard me talk before about wifi networks are not secure in the public domain. They have a purpose for us in certain instances around major sporting events and so forth, but our customers are very concerned about their privacy and security. That's why they ride the LTE network as much as they do.

But we do want offload in certain circumstances, and so that does relieve some of the spectrum. We obviously, just from a utilization standpoint, for people that are in their homes, it's not good and efficient to run off the LTE network. They should shift over to their wifi network in their house. So we do encourage that, but again, not major, massive, public wifi is interesting for our customers, at least at this point in time, from a security standpoint.

Operator

Our next question comes from David Barden of Bank of America Merrill Lynch. Your line is open.

David Barden - Bank of America Merrill Lynch

Just following up a little bit on that, Fran, I was wondering if you could give us a status update on the activities and development that's going on inside that joint innovation entity with the Comcast group, and what progress, if any, is being made on some of the digital content rights stuff?

And then I guess second would be kind of along those lines. Could you elaborate a little bit on your relationship with NFL, and kind of some of the strategy behind that content relationship and if that's the beginning of a series of potential new moves to acquire content?

And if I could, just one quick last one, I noticed the strategic services sales and enterprise were a a little over 6% growth year over year last quarter. They kind of slowed down into the 4% zipcode this quarter. I know overall enterprise has been fairly soft, but strategic services has been kind of a core strength. If you could kind of address that slowdown, it would be helpful.

Fran Shammo

Around our joint venture with the cable companies, obviously our [unintelligible] solutions team has been working and defining consumers as to what they want both in the home and outside the home.

And obviously what we're learning is the 4G LTE network plays a very critical role in that. We continue to work with them. We have expanded into 968 Verizon Wireless stores across the U.S., and we have about 2,500 indirect locations, the marketing material, and we continue to showcase these types of products.

But I will say that as we continue to work through this, it's hard for Verizon Wireless to sell a cable product outside of the FiOS footprint, because it's new. And it's hard for the cable companies to sell a wireless product outside the footprint, because of the distribution channels. So as we continue to work through this, we're gaining some momentum here.

But I think the one last point from all this is we're obviously very focused on the content rights. And you come into the NFL agreement, and the NFL agreement we think is just a new way of how content rights can be delivered into the wireless segment. And obviously our strategy is around both type of multicasting a live sporting event, and you saw our comments that the 2014 Super Bowl will be a multicast type event to our wireless customers.

So that's really the breakdown of the wall between what can be delivered in the home and out of the home. And obviously we now have the rights to take some of the NFL live games out of the home and deliver them on the mobile devices.

From a content standpoint, this has to develop, obviously, over time. The other point here around content is we are starting to see where we're getting inquiries from content providers that they may want to pay for their content rather than having the consumer pay. Those models are still being worked, but we'll see where that goes. But I look at that as the old 1-800 number, where the actual vendor pays for the usage, and not the customer. So we'll see how that strategy develops over the course of time.

As far as our strategic services go, we continue to have good momentum in our strat services as we refine exactly what we're doing. We have very good momentum in the Terremark and the Hughes platforms, and around our cloud services.

The slowdown, quite honestly, has been around our PIP exercise, and that is growing, but it's more a price compression within the industry. So we're facing some of that going forward. And we knew we were going to face some price compression around PIP, and we have to accelerate on the other strategic services to outpace that.

So, other than that, we have good momentum on strat services.

David Barden - Bank of America Merrill Lynch

And just to clarify, PIP is?

Fran Shammo

IP-based solutions.

Operator

Our next question comes from Tom Seitz of Jefferies. Your line is open.

Tom Seitz - Jefferies

Can you just give us an update on your expectations for VoLTE?

Fran Shammo

We're still on course for VoLTE. We will start testing and have our first handset in the market at the end of the year. And then we will probably commercial launch sometime next year. But again, as I've said in the past, the critical piece for us is that we have to make sure that our 4G LTE coverage footprint from a VoLTE standpoint equates to our 3G footprint, because the VoLTE call is not backwards compatible with the CDMA network. So when you establish a call on VoLTE, within our network, if you move outside of the LTE network, you will have a hard drop on that call. And obviously that's not something that our customers would expect from a premium provider like Verizon Wireless.

So we're taking our time here. We will thoroughly test this. But we are on track to commercially launch sometime in the first half of next year. And then taking that out, as I've said, at the end of next year, we are on track to have our first only LTE handset to be able to provide to the marketplace as well. So we're still on track with our VoLTE strategy, but it is a critical one for us to make sure that we get right when we launch.

Tom Seitz - Jefferies

So the implication, though, then, is that the 4G network is going to be essentially everywhere that the 3G network is by sometime in the first half of next year?

Fran Shammo

The 4G network is everywhere. As I said in my opening remarks, 99% of the coverage of our 4G network is equivalent to our 3G network. But now we have to go back in and fill in that capacity to make sure that from a voice call perspective, it will hand off, because voice is different than the data piece. So we just have to make sure that a customer who is on 3G today, when they go to VoLTE, they would see no difference in their service from 3G to 4G.

Tom Seitz - Jefferies

Could I just follow up on Dave's question? There were press reports that ESPN was considering subsidizing mobile video consumption. And you sort of alluded to that as well. How soon do you think we'll see a material third party payer model? Is it this year? Is it next? Is it a couple of years out? Can you just sort of frame the timeframe of what you're thinking about?

Fran Shammo

I think the big barrier right now is how does the content provider get the value of how many people watch their content on a mobile device to be able to go back to their advertisers in order to monetize that content? And right now that's where the barrier is, and we're working on that. But until that get solved, I think this model will be slow at this point in time.

Now, slow to come, I'm thinking maybe next year. But it's certainly not any time in this year that that model will break through. Because they have to recognize the benefit back to their advertisers to be able to monetize that content into our network.

But it is something that's being discussed. They realize that the linear model will not work as it does in TV in the wireless market. You can't assume that someone's going to pay $8 a sub on 100 million subs, so that model does not work. So we are looking at other models, but the barrier is how do you measure everything to get back to the advertisers for the perceived value on that content?

Operator

Our next question is from Amir Rozwadowski of Barclays. Your line is open.

Amir Rozwadowski - Barclays

Just on the capital expenditure front, on the back of this capital expenditure rise for the year, I wanted to ask how we should think about the capital intensity of the business going forward. It does seem as though your competitors are healthily ramping their efforts to try and improve service quality. Do you feel as though you'll need to continue to put your foot on the gas in order to maintain the quality of your network?

Fran Shammo

Well, let's put this in perspective. We've moved our consensus by $200 million to $400 million, so this is not a huge step up in our capital spend. We just wanted to make sure everybody realized that we were going to accelerate some of the 4G LTE.

But as we've said in the past, and if you look at our results through the first half of the year, we continue to really be disciplined around the capital investment across our businesses, but also within the wireline segments. So you see that come down year over year. We expect that trend to continue. So that will offset some of the pressure that we may see on the wireless side.

So I don't anticipate that there's going to be any major accelerations, but again, it's too soon to tell where we're going to come out in '13. I'll talk more about that in the coming quarters, but right now the focus is on this year and it's between $200 million and $400 million increment.

Amir Rozwadowski - Barclays

If I may, we've clearly seen a pickup in terms of your shared data plans. I think you mentioned that it's more than 36% of your subscribers that are on these plans. I was thinking from a strategic perspective, as we've seen increased promotional activities by some of your competitors to try and wean subscribers onto their networks, do you feel as though this is a potential mode in terms of protecting your subscriber base from some of these more aggressive pricing plans that are available in the market? Should we expect to see more promotional activity to try and ratchet this sort of percent of subscribers on shared data plans up in the coming quarters?

Fran Shammo

This industry has always been an extremely competitive industry, and obviously some of the promotions around unlimited have been there for the last year, when we launched share pricing. And we continue to take market share, we continue to grow our revenue very strongly.

So look, I mean, Verizon Wireless will do one thing very well. They will compete very well in the market, but we are a balanced company. We will compete, grow revenue, grow profitability, and grow our subscribers.

And at the end of the day, customers make choices not really just on price, but the quality of the network, and that's what we've built our brand on. So quality of the network, consistency of the network, the reliability of the network, the value that we provide to our customers through these shared plans.

And again, will we do promos here and there? Of course. As I said before, we'll launch the Verizon Edge, which will give our customers yet another choice of how do they want to enter onto the best network there. So I think the key here is give our customers choice, and continue with what we've built our company on, which is the strongest network.

Operator

Our last question comes from Tim Horan of Oppenheimer. Your line is open.

Tim Horan - Oppenheimer

Two questions on wireless. Fran, you talked about the fact that your LTE network is enabling you to attract a higher quality customer, which has clearly been the case for a long time with your network. But do you have any evidence on that on maybe credit scores? Are you finding with what you've done on LTE and the shared data plans, are you attracting higher credit quality scores, maybe losing lower quality score customers?

And then secondly, on the shared data plans, can you maybe talk about what you're seeing in terms of customers needing to increase their data buckets or many customers bumping up against headroom? Or do you expect to see an acceleration of that in the next year? Or is it more like two to three years out?

Fran Shammo

On the high quality, obviously we give a lot of our customers choice of various price plans and how to enter into our superior network. And of course credit scores have always been a component of that. I won't really get into how we differentiate the credit scores, but obviously you can see that from the growth that we have and the revenue growth that we have, this is not a major issue for us. And we watch this very closely, but we're gaining customers across all aspects of the business, let's just put it that way.

Shared data plan, as far as acceleration of data usage, again, what we see, and if you've experienced this yourselves, we continually communicate with our customers throughout the month as to when they get to their usage, and then when they get up into that 90%, we give them the ability to upgrade through their phone to the next tier.

And we see some very good results from that. Customers are upgrading when they need to. So, again, based on our trajectory of data usage, especially with where we see video going, we continue to see that the uptake in the shared plan will continue, the usage will continue to accelerate, and our revenue growth will be reflective of that.

Michael Stefanski

That's all the time we have for questions. But before we end the call, I'd like to turn the call back to Fran for some closing comments.

Fran Shammo

Thanks, Mike. I just want to leave just a couple points of emphasis here. Our strategic investments and operational execution drove strong financial performance in the first half of this year. But while we are pleased with the overall performance, we obviously know we have more work to do.

We are committed to driving shareholder value by continuing to execute our strategy and improve on the fundamentals of the business. We are focused on delivering superior customer service and providing the best portfolio of products, along with the most reliable and consistent performing network. Our focus is to capture incremental revenue growth in our key strategic areas while we also transform our service delivery and cost structure.

As always, we will continue to be very disciplined around our capital investments, investing in those platforms for the innovation and the growth of the future. Through this strategy and execution model, we expect to drive incremental cash flow and earnings growth, both in the second half of this year and into the future.

Thank you again for joining us, and everybody have a great day.

Executives

Michael Stefanski - SVP, Investor Relations

Fran Shammo - EVP & CFO

Analysts

Phil Cusick - JPMorgan

Jason Armstrong - Goldman Sachs

John Hodulik - UBS

Simon Flannery - Morgan Stanley

Michael Rollins - Citi Investment Research

Mike McCormack - Nomura

Jennifer Fritzsche - Wells Fargo

Brett Feldman - Deutsche Bank

David Barden - Bank of America Merrill Lynch

Tom Seitz - Jefferies

Amir Rozwadowski - Barclays

Tim Horan - Oppenheimer

Verizon Communications Inc. (VZ) Q2 2013 Earnings Call July 18, 2013 8:30 AM ET

Operator

Michael Stefanski - SVP, Investor Relations

Good morning and welcome to the Verizon second quarter 2013 earnings conference call. [Operator instructions.] It is now my pleasure to turn the call over to your host, Mr. Michael Stefanski, senior vice president, investor relations.

Michael Stefanski - SVP, Investor Relations

Thanks, operator. Good morning, and welcome to our second quarter 2013 earnings conference call. This is Mike Stefanski, and I'm here with our chief financial officer, Fran Shammo. Thank you for joining us this morning

Before we get started, let me remind you that our earnings release, financial and operating information, the investor quarterly, and the presentation slides are available on our Investor Relations website. Replays and a transcript of this call will be available on our website later today.

I would also like to draw your attention to our safe harbor statement. 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 also 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 also available on our website.

Before Fran takes you through the details, I would like to make you aware of a non-operational item included in the quarterly results. For the second quarter, we reported earnings of $0.78 per share on a GAAP basis. These results include $147 million after tax, or $0.05, for the favorable effect of an interim actuarial remeasurement associated with one of our pension plans, due to settlement accounting.

The noncash credits were due primarily to an increase in the discount rate assumption used to determine our current pension liability. On an adjusted basis, EPS was $0.73, compared with $0.64 a year ago.

Our discussion of consolidated results and growth rates in this presentation exclude the effect of the nonoperational gain. In addition, the quarterly growth rates disclosed in this presentation are on a year-over-year basis, unless otherwise noted as sequential.

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

Fran Shammo - EVP & CFO

Thanks, Mike. Good morning everyone. Our strategic investments in 4G LTE, FiOS, global IP, and cloud services continue to drive strong operating performance. We are executing well in these key growth areas.

Overall, consistent top line growth, along a strong focus on cost efficiency and profitably, resulted in double-digit growth in operating income and earnings per share in the second quarter. In fact, we have posted double digit earnings growth in five of the last six quarters.

Second quarter adjusted EPS was $0.73, up 14.1%. Year to date, adjusted earnings per share were $1.41, representing 14.6% growth. As you know, our strategy focus is on building networks and platforms as the foundation for innovation and growth.

Underpinning our success is the consistent investment in these networks and platforms, which position us to take advantage of growth opportunities in the rapidly evolving wireless and wireline markets for broadband, video, and cloud services.

Operationally, we are focused on increasing value by delivering products and services to customers in the most efficient and effective way possible. In wireless, our Share Everything plans are a great example. We have simplified decisions for customers, making it easy to add new devices and manage their shared data usage.

Our FiOS Quantum offer, where customers can upgrade broadband speeds themselves, is another example of improving service quality and increasing operational efficiency. Throughout the entire business, there are many examples where Verizon Lean Six Sigma principles are being adopted, and we are realizing efficiency gains in a number of areas, including customer care, supply chain, and system support.

As we move through the year, we are confident that successful execution in our key strategic areas will continue to drive incremental revenue and promote operating efficiency, resulting in sustainable growth in free cash flow and earnings.

Let me shift now to our second quarter performance, hitting a few highlights. Our wireless results were strong, once again effectively balancing growth and profitability. We added 941,000 retail post-paid connections, up nearly 40% sequentially. Service revenue grew more than 8%, EBITDA growth was up double digits, and our EBITDA service margin was 49.8%, solidly within our annual margin guidance.

We also had a strong quarter of customer and revenue growth in FiOS. Revenues were up nearly 15%, and we added 161,000 new subscribers in FiOS internet and 140,000 in FiOS video, roughly 20% more than we added in the second quarter last year.

In global enterprise, strategic services revenue grew 4.8%. Our consistent operating performance, together with disciplined capital spending, is driving higher free cash flow. Through the first half of the year, free cash flow increased by more than 20%, resulting in an improving return on investment profile for the entire business.

Now let’s take a brief look at consolidated results, starting with slide four. Total operating revenue grew 4.3%, sustaining our solid top line growth performance. For the quarter, the increase in consolidated revenues, coupled with effective cost management, resulted in 11.8% growth in adjusted operating income.

On an adjusted basis, consolidated EBITDA increased to $10.5 billion, and our EBITDA margin expanded by 90 basis points to 35.1%. Now let's move into a review of the segments, starting with wireless on slide five.

We have emphasized that consistent investment in wireless drives our leadership in network quality, reliability, and the overall customer experience. Our commitment to 4G LTE covers a wide range of activities, including the securing of necessary spectrum, the allocation and deployment of capital for both coverage and capacity, our leadership in fostering a robust device and application ecosystem, and the success of our Share Everything plans in driving device adoption and stimulating usage.

Once again, our second quarter wireless results demonstrate the effective execution of this strategy. Total wireless revenues grew to $20 billion, representing 67% of Verizon's consolidated revenue. We sustained strong service revenue growth of 8.3%, making it the third consecutive quarter of growth in excess of 8%. EBITDA increased to $8.5 billion, and our EBITDA service margin expanded by 80 basis points year over year to 49.8%, representing another very strong quarter of growth and profitably.

Let's now turn to a more detailed look at wireless revenue per account, beginning on slide six. Service revenue growth continues to be driven by increasing connections, smartphone penetration gains, and data usage. The simplicity and value proposition of our Share Everything plans is driving device adoption and stimulating higher usage, resulting in increases in both the number of devices and revenue per account.

During the second quarter, retail post-paid service revenue per account, or RPA, grew 6.4% to $152.50 per month. We have 35 million post-paid accounts, and the average connection per account increased to 2.7, up 5.5%.

Our Share Everything plans have been very successful. The plans have been available since June 28 of last year, and customer adoption has been very strong. In just one year, more than 36% of our post-paid accounts are on a Share Everything plan. The value proposition is simple and straightforward, and customers increasingly recognize the value of shared data across multiple devices.

Let's take a closer look at connections growth on slide 7. As I highlighted earlier, we added 941,000 new retail post-paid connections, up from 677,000 in the first quarter, and about 6% higher than a year ago. We also added 97,000 retail prepaid connections, so our retail net connections totaled just over 1 million in the quarter.

As I stated on our last earnings call, we expect to continue to see sequential quarterly net add improvement in 2013. Total retail connections topped the 100 million mark in the quarter. Our industry-leading post-paid base stood at 94.3 million, and we have more than 5.8 million prepaid connections.

Our connections growth was driven by another strong quarter of gross additions. Postpaid gross adds of 3.6 million were up 14.2% year over year. The number of customer upgrades also increased by sequentially and year over year, with a postpaid upgrade rate of 7% for the quarter. We continue to expect that our annual upgrade rate will be about the same as last year. Our upgrades remain high quality, with 36% of customers purchasing a smartphone for the first time.

We also maintained a high quality mix within our postpaid net adds. We added 472,000 in the phone category. Of this total, 974,000 were smartphones, with the balance representing the decline in basic phones. We added 371,000 internet devices, including tablets. The balance of just below 100,000 included Home Phone Connect, Home Fusion, and other connected devices.

Our churn metrics continue to be market-leading. Retail postpaid churn was 0.93%. The sequential improvement was due primarily to an expected reduction in involuntary churn, as discussed coming out of the first quarter.

Next, let's turn to slide eight and take a look at device sales and our progress in 4G LTE. Postpaid device activations totaled 10.1 million in the quarter, representing both a sequential and year over year increase. We had a high quality device mix once again, with 88% of the activations being phones.

Smartphone activations totaled 7.5 million, and 72% of them were 4G LTE. The smartphone mix was fairly balanced; roughly 51% of the activations were iPhones. Our smartphone penetration continued to improve, and we ended the quarter at over 64%. We had another strong quarter for internet devices. Activations of these devices, which include mobile hotspots, jet packs, and tablets, topped 1 million again this quarter.

Adoption of 4G LTE smartphones and devices continued to accelerate. One-third of our retail postpaid connections are now 4G LTE, compared to just 12% one year ago. 46% of our smartphones, and more than two-thirds of our internet devices are 4G LTE. Currently, 59% of our total data traffic is carried on the 4G LTE network, which is five times more efficient than the 3G network.

In terms of geographic coverage, we now cover 500 U.S. markets with 4G LTE, and have essentially completed our buildout by matching our 3G footprint. Our LTE network covers more than 99% of our 3G footprint, and when you include our rural America partners, LTE is available to about 301 million across the nation.

Throughout the rest of this year, we will continue to invest, adding capacity to our existing 4G coverage, ensuring that customers are receiving the quality and consistent reliability that they expect from our network and devices. I will cover our capital spending outlook in more detail during our discussion of cash flows.

Let’s move next to our wireline segment, starting on slide nine. Our wireline investments and platforms, such as FiOS, global IP, security, cloud services, and machine-to-machine, enable us to deliver the services and leading-edge applications and solutions that customers want. As these services scale, they will become increasingly efficient, and will help improve our cost structure in the long run.

Total wireline revenues decreased 2% in the second quarter, as growth in FiOS and strategic services were offset by softer global enterprise and wholesale revenue from legacy transport services and CPE.

In terms of wireline segment margin, second quarter EBITDA increased to $2.2 billion, and the margin was 22.2%, up 80 basis points sequentially. We continue to believe we can improve the wireline segment margin in 2014. Let’s take a closer look at the revenue components, starting on slide 10.

In the consumer and mass markets business, we continue to see positive signs, highlighted by sustained FiOS revenue growth. Consumer revenues grew 4.7%, driven by FiOS, which now represents 71% of consumer revenue. Our overall consumer monthly RPU increased 9.4% to more than $109, and we sustained a blended FiOS RPU at over $150 per month.

Two-thirds of our FiOS customers are triple play, which have a higher amount of recurring revenue per month. As I highlighted earlier, we had a good quarter of FiOS customer growth. In terms of broadband, we had 161,000 new FiOS internet additions and now have 5.8 million subscribers, representing penetration of 39%.

Overall, net broadband subscribers were a positive 45,000. In FiOS video, we added 140,000 new subscribers in the quarter, bringing our total to 5 million, which is over 34% penetration.

In addition to the customer growth and increased penetration, we are also gaining traction with our FiOS Quantum offers for higher broadband speeds. Sales of our FiOS internet product, at speeds in excess of 50 MB per second, increased during the quarter, and existing customers continue to buy up in the speed. At the end of the quarter, one-third of FiOS internet customers subscribed to Quantum, with speeds ranging from 50 to 300 MB per second.

We continue to make steady progress with copper migrations, increasing the number of service upgrades each quarter. During the second quarter, we converted more than 86,000 customers. Through the first half, our total was 169,000, so we are more than halfway to our target of 300,000 for the year.

This network evolution initiative is important for us as we reduce our dependency on older technologies. Aside from the maintenance expense savings, and improvements in customer satisfaction, conversions to fiber also provide customers the opportunity to purchase FiOS services, which could result in additional RPU over time.

Another positive result in the quarter was the steady improvement in our residential connection trends. Retail residential connections declined by 5.2%, compared with a loss of 6.6% at this time last year. We expect that continued strength of FiOS, the copper migration initiative, and the benefits of labor contracts and work rule flexibility will have a positive effect on wireline profitably this year.

Let’s move to our enterprise markets next, on slide 11. In the second quarter, global enterprise revenue declined $184 million, or 4.8%. CPE sales, which were down 34% year over year, represented $162 million of the decrease. Excluding the decline in CPE, global enterprise revenue was down less than 1% on a year over year basis.

Strategic services, which now comprise 57% of enterprise revenue, grew 4.8%. In the second quarter, the continued decline in legacy transport services more than offset the growth in strategic services.

We continue to work through economic challenges in the enterprise space. Many of our customers are focused on improving their cost structure, which can result in reduced services with us. In addition, many customers continue to be cautious regarding new investment decisions.

Moving next to global wholesale, quarterly revenues declined $141 million, or 7.7%, due primarily to continued declines in the transport services. Again, our strategy is to better monetize our global IP and fiber network by driving a more efficient migration to next-generation Ethernet services.

In terms of profitably, while growth in the enterprise strategic services is improving the revenue mix, volume declines in the rest of global enterprise and wholesale continue to put pressure on wireline margins. Through our Verizon Lean Six Sigma program, we are making good progress in our cost restructuring programs and retooling efforts, which we believe will improve our operating efficiency.

Let's turn to slide 12 for a discussion of our cash flow results. Our cash generation remained very strong. For the first half of this year, cash flows from operations increased by 12%. Free cash flow was up by more than 21%.

Capital expenditures for the quarter totaled $4 billion and were $7.6 billion year to date, up 2.5%. Wireless capital spending in the second quarter totaled $2.3 billion. Through the first half, wireless capex totaled $4.3 billion, 8.6% higher than last year.

As I noted earlier, we have essentially completed our initial LTE buildout by matching our 3G footprint. Throughout the rest of the year, we will continue to invest by adding capacity to our existing coverage as we begin to deploy AWS spectrum throughout the network.

In wireline, capital expenditures totaled $1.5 billion in the quarter and $2.9 billion year to date, which was down 5.9% from last year. Strong connections growth, driven by 4G LTE, and our Share Everything plans, has resulted in higher demand forecasts and a need for increased capital investment.

As such, we are increasing our full year capital spending outlook from flat at $16.2 billion to between $16.4 billion and $16.6 billion. We remain focused on improving investment returns and capital efficiency, and we continue to expect our capex to revenue ratio for the full year to improve, even with the additional investments in 4G LTE.

Our balance sheet and credit metrics remain very strong. Total debt at the end of the second quarter was just under $50 billion, and our net debt to adjusted EBITDA ratio was about 1.2x. Let's summarize on slide 13.

Our second quarter results showed consistently good performance in the key strategic growth areas, so at the halfway point, the key year to date financial and operating metrics are strong: consolidated revenue growth of 4.2%; operating income up 15.6%; adjusted earnings of $1.41 per share, representing 14.6% growth.

In wireless, service revenue growth up a very strong 8.4%; average revenue per account up 6.7%; retail post-paid additions of 1.6 million, up 16.5%; EBITDA growth of 14%, and an EBITDA service margin of 50.1%. We are on track to deliver on our 49-50% margin guidance for the full year.

In wireline, consumer revenue growth of 4.5%, driven by FiOS growth of nearly 15%, 349,000 subscribers in FiOS internet, and 309,000 in FiOS video. We are on track to meet our 600,000-plus FiOS customer growth target.

Free cash flow generation is up better than 20% year over year, and our balance sheet remains very strong. All in all, a very good first half. We are now focused on continuing the momentum, which should result in a strong second half of the year.

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

Michael Stefanski - SVP, Investor Relations

Fran, thank you. Operator, we're now ready to take questions.

Question-and-Answer Session

Operator

[Operator instructions.] Our first question comes from Phil Cusick with JPMorgan. Please go ahead with your question.

Phil Cusick - JPMorgan

Two around wireless. First, you talked about sequential improvements in adds in the third and fourth quarter. Given that Sprint's not going to be seeding a number of items into the market, in what's traditionally not a strong third quarter, can you help us see why you're more confident there?

And second, can you talk about how you expect margins to track through the remainder of this year? Given the upgrade comment you just made about being flat year over year, that's a little higher than I would have thought given the commentary, or the change for the fourth quarter. Can you just talk about those?

Fran Shammo - EVP & CFO

On the sequential third and fourth quarter, it's similar to the trend that we saw last year when coming out of the first and second quarter. We said we would sequentially continue to see growth in the third and fourth quarter. And again, this is around what we expect the roadmap to be on additional device launches throughout the third and fourth quarter.

But the momentum that we have, and you see that momentum coming out of second quarter, and I'll talk more to that in a second when we get to the margins, we continue to see this high-quality subscriber coming onto the wireless 4G LTE network, and we don't see that changing at this point.

From a Sprint and porting ratio, I won't get into specific individual carriers, but again, pretty consistently positive with all carriers from a porting ratio perspective.

On the margin side of the house, I think we have to put this in perspective. Again, we are fully engaged on the 49-50% guidance that I gave to you in the beginning of the year , and if you look at the first half of the year at 50.1% for the first half and coming out of this quarter at 49.8%.

And I think you have to look at what's behind that. So if you look at, on a year over year basis, just between the quarters, we improved our profitably by 80 basis points. In that, if you look at that, we moved 7.5 million smartphones. 1.6 million of that was additional smartphones over last year. And then if you just look at the 4G devices, we moved 3.1 million more 4G devices this year than we did a year ago.

And in that, if you look at the service revenue growth of 8.3%, that's up 100 basis points over where we were last year. So you can see the quality of these adds, and if you take what we added in the quarter of nets, with 472,000 net phone, it's a pretty good indication of what we're going to drive from a margin perspective.

And then if you look at the network side of this, with 4G LTE, we now have 33% of our customers on that network, 36% of our customers on shared. We had a growth of 5.5% in the connected devices. And I've said that our growth is really dependent on two things. Number one, the 4G LTE network, and as people move over there, the usage of stimulation drives them into higher tiers from a tier perspective on the shared plan.

And then of course the second piece is, as they get on the shared plan, they start to connect all these additional devices. And you can see that with the continued momentum of our internet category and some other things that will be coming to market similar to what we did in the fourth quarter last year as for the camera.

So, combination of all these. I am very confident that we will continue on the margin track that we set out at the beginning of the year.

Operator

Our next question comes from Jason Armstrong of Goldman Sachs. Your line is open.

Jason Armstrong - Goldman Sachs

Fran, there's been obviously some buzz around Verizon investing in Canada. Maybe you can help us in terms of where you see the opportunity. Is this tied into a roaming footprint? Is it tied to maybe serving your own enterprise customer base? Or is there sort of a consumer retail presence you might have in mind tied to this?

And then second question, on FiOS, very good volumes in what's generally a seasonally weak quarter. You talked about the 600 plus, that it seems like you have the opportunity to maybe be meaningfully above that result. I'm just wondering, does what you've seen in Q2 give you the opportunity to maybe set the bar higher for the year?

Fran Shammo - EVP & CFO

On Canada, again, let me emphasize this is really an exploratory exercise for us. As you all know, they've delayed their spectrum auction until January.

So, again, we continue to just look at this market. I think it's everything that you said that we're kind of looking at. If you look at the population of Canada, about 70% of that population is between Toronto and Quebec. That's adjacent to the Verizon Wireless properties. Again, if you look at the spectrum auction, it mirrors up exactly what we launched here in the United States on the 700 MHz contiguous footprint.

So we're looking at all these, but obviously some of the cautions here are the regulatory environment, a foreign investor coming into the Canadian market and what does that mean? So again, cautiously looking at it. Not ready to make any announcements today. And we continue to explore and have discussions, but at this point it's just really an exploratory exercise.

On the FiOS volumes, again we put a lot of effort around continuing the superiority of the FiOS product. Bobby and his team have done a great job in and around the FiOS Quantum offers and a lot of the stimulated growth that we see here is coming from the Quantum offers that we have, and upgrading those Quantum offers to the 50 and 70 MB per second services.

So look, we set a target for 600,000. Obviously if we can exceed that target, we will. We're ahead of that target, but I will tell you that the third quarter, again, is always a seasonally challenging quarter for us from a move perspective. So let's continue on the track that we are, and if we can overdeliver, we will, but we've set the target at 600,000.

Operator

Our next question comes from John Hodulik of UBS. Your line is open.

John Hodulik - UBS

Quick question on wireline and then wireless. First, on wireline, Fran, in your prepared remarks you mentioned a couple of issues driving wireline profitability, that you see some improvement. I just wanted to see if I could get a little clarification. Are you talking about the year over year trends for the whole year? Or just the second half? If you could just sort of fill in the blanks for us, that would be great.

And then secondly, on the wireless capex increase, can you just talk a little bit about what's driving that? Is it more 4G devices? Is it more usage per device? Or is it maybe the competitive environment and what you're seeing from other carriers? What's really driving the change there?

Fran Shammo - EVP & CFO

So in wireline possibility, look, we set the bar that said our margin would be flat year over year. Going into obviously in the third and fourth quarters of last year, compared to what we think we can do this year, and coming out of the second quarter, I think in the back half I have to improve the profitability in order to continue to make that guidance that we set out at the beginning of the year that said we would be flat on a margin basis. So I think we're on course to do that, and mathematically, the profit has to get better in the back half of the year in order to sustain that guidance.

As far as the capex on wireless goes, there's a couple of things here that are driving this. If you look at, over the last three quarters, the growth that we've had, the number of 4G devices we've moved, and if you look at just the first half of this year versus the first half of last year, we've added 6.2 million more 4G devices on the 4G network than we had a year ago, from just an overall sale perspective.

So when you look at that and you look at the usage, currently 59% of the data traffic is now running on the 4G network. And that's being driven by 33% of the base. So again, from just a growth perspective on the top line, we've always said, again, that as customers move into shared, and they realize the viability and speeds, and the consistency of this 4G network, it's going to drive them to use higher usage. And if you look at where video's going in the future, obviously that's going to continue the proliferation of the usage on this network.

And we look out two years ahead of where we think our curve is going to be, and given the past success we've had, and the usage patterns, and the amount of 4G devices that we've already moved, and the roadmap that we see coming, we need to accelerate really the capacity that we previously thought. And it's really all to drive what customers want.

So the incremental investment will more than pay for itself on top line growth, from what I see. And again, this is really a shift in our capital discipline between wireline and wireless. And we're going to maintain our lead on the most reliable, consistent 4G LTE network. So that's what's driving the increase for the capex.

Operator

Our next question comes from Simon Flannery of Morgan Stanley. Your line is open.

Simon Flannery - Morgan Stanley

Other wireless service revenues were very strong, up about 20% year over year. I imagine you've got some MBNOs and maybe roaming and other stuff. Perhaps you could just comment on the drivers of that and the sustainability of that.

And then on the enterprise side, you talked about continued cautious behavior and cost focus. Do you see any signs of a second half pickup? I think there's some better news on unemployment and generally macro trends improving in the second half. Are you seeing any of that? Or is it pretty much static from your point of view?

Fran Shammo - EVP & CFO

On the other wireless revenue, obviously what's included in that other wireless revenue is our reseller base. I don't like to refer to them as MBNOs. That's a bad word for me. But on the reseller base, it's really driven from the prepaid providers that we have on that side of the business.

And again, coming out of this quarter, we did a fairly substantial number of net adds there. And again, our prepay strategy is between what we sell on the retail side under our own brand, and we had a positive quarter again this quarter, with 97,000 net adds.

But we also drive the, if you want, the lower-end market through resellers, and mainly through the relationship with Walmart, through Tracfone. So that drives a lot of volume, and that has been good revenue growth for us.

The other things I would tell you, though, is that in addition to that, obviously roaming is in there, machine-to-machine , which we don't really talk about much. We're gaining a lot of momentum around machine-to-machine, and that is driving incremental revenue, albeit very low individual unit per subscriber type revenues, but again, as we start to gain momentum and sell hundreds and hundreds of thousands of these types of devices, that's going to contribute to those revenues and contribute to the overall growth of wireless. So that's the component of that.

On the enterprise side, look, I understand the unemployment is there, but it's not large enough and steady enough to give me confidence that something's going to turn here in the near future. And again, if you look at the enterprise space, mainly what everybody is focused on is cutting their costs.

And obviously when we talk about cutting costs in enterprise, they come to us and figure out how they can reduce their spend with Verizon and have us give them solutions that help them reduce their spend. And of course we're happy to do that, but it does cause some top line pressure.

And also, I think, again, the uncertainty of what's going on around the government sector, is twofold. Number one, a lot of this pressure in enterprise this quarter, if you look at the decline of 4.8%, over 60% of that was in the government sector for us this quarter. So there is a big impact from the sequestering activity and the pullback from both the state and local governments, and also within the federal government.

As I look forward, though, the uncertainty around this tax situation, and if you think about it, we're now midway through the year, it's highly unlikely that we'll get tax reform this year. So again, we're faced with another cliff at the end of the year if congress does not extend the tax provisions that are currently on the books for another year.

So hopefully they'll do that soon and put some of the uncertainty to rest, at least until the next 18 months, until we can get to all the difficult issues around tax reform, which as you know we have a lot of subgroups working in Washington to help and give suggestions on how to get this done. But that's going to take some time.

Again, it's hard for companies to say we're going to invest in new technologies and new things, when we're not certain what the future of the tax laws hold for the books and records. So I still don't think anything's going to change drastically from where we are. And as I said before, at least from where I sit, the best we can hope for is a flat performance, and if you take CPE out of the equation this quarter, we're at a [0.8%] decline. So that's probably about where we'll be, zero to slightly decline, or slightly positive is kind of where I'm at at this point in time.

Operator

Our next question comes from Michael Rollins of Citi Investment Research. Your line is open.

Michael Rollins - Citi Investment Research

Could you just give us the update on the net debt calculation for Verizon Wireless? And then with respect to the business, I think the metrics that you threw out there on the LTE network implies about 1.8 more usage on the LTE network versus the 3G network. And I was wondering if you could expand on that a little bit more, and maybe give us a sense of what the usage trends are for your customers. And as they move into the shared data plans, if you could give us a sense of that kind of stimulus that you're seeing on the consumption front.

Fran Shammo - EVP & CFO

On the update of the net debt for wireless growth, that is $10.1 billion, and net debt is $9.7 billion. And as you know, we did a distribution at the end of June of a total of $7 billion out of the partnership to both of the owners. And also, just to keep in focus here, we have about $1.5 billion of wireless debt coming due in the fourth quarter of this year and another approximately $3.5 billion coming due in the first quarter of next year, and we plan to pay that debt off at that point in time.

On the LTE network, you're right on. Obviously what's happening is as people come from the 3G network over to the 4G network, you can see that incremental usage, whether it's a smartphone or a jet pack or a dongle. And as they start to share all this data, the video consumption is increasing year over year and quarter over quarter.

Others in the industry have put out their projections of usage over the 4G data, if you look at some of the things that people have printed, and the escalation that the future holds from a data consumption standpoint as we start to move into more symmetry between in the home and out of the home content. We don't see that slowing, so again, yes, we do see an incredible jump when someone moves from 3G to 4G and the usage that they have on their smartphones and other devices. So that's what's driving the growth.

Operator

Our next question comes from Mike McCormack of Nomura. Your line is open.

Mike McCormack - Nomura

Maybe just a comment on wireless margin. I know you've got the sort of 49-50% expectation for the full year. Last year the fourth quarter had very high volumes that sort of really dragged down margins a bit. Are you getting comfort that the new upgrade policy should have a muting impact on that? And then just secondly, on FiOS competition, maybe just some comments regarding the triple play pricing environment out there, and also how well you're doing in the [MDU] market.

Fran Shammo - EVP & CFO

On the wireless margins, obviously, again, we're very confident around the 49-50%. As far as the fourth quarter of last year, you have to keep in mind it was the first quarter that there was a free iPhone on the Verizon Wireless network, and we won't have that repeated this fourth quarter. Now, that's not to say that we don't see increasing volume. And again, I continue to say that we'll see incremental net adds through the third and into the fourth quarter.

But from a margin perspective, if you look at just year over year and the amount of volume we've moved, we actually ate through all that volume and improved the profitability of this business. And that goes into managing the entire business.

So from an upgrade policy standpoint, some other things that we'll be launching. You probably saw Verizon Edge and some other options that we'll have on payment plans for our customers to acquire a smartphone. All of these things considered, we are very, very positive on the margin progress and the profitability progress of Verizon Wireless and the continued growth of Verizon Wireless.

Mike McCormack - Nomura

Just on the Edge comment, is that something that you're hearing your customers actually demanding, the sort of equipment financing option?

Fran Shammo - EVP & CFO

If you look back, we were the first carrier to launch LTE technology, we were the first ones to launch the shared pricing around LTE technology. We launched in the fourth quarter of last year an installment pay plan on tablets. That was something that our customers were asking for. We delivered that to them.

And at that point in time, we started to look at it, and I said we were looking at other options for smartphones. We've done a lot of focus groups in the last six months. We've done a lot of market research. And yes, our customers are asking for another option.

Twofold: Number one, we have a lot of customers on the technology edge that want to be able to upgrade sooner than they would under our historical legacy subsidy model, if you will. And we have other customers who quite honestly don't want to pay up front for the large cost of the phone. They'd rather pay over time.

So I'm not going to get into all the details of Verizon Edge, I'll let Wireless do that, but that's something that our customers have been asking for, and I think we have a differentiated plan to launch to the market and Verizon Wireless will have more to say on that.

Going back to your other question on triple play and MDU, obviously we continue to gain momentum here. Look, this business has always been competitive around the triple play, but I think what's differentiating us right now is the superiority of our product with fiber into the home.

And as you get that fiber into the home, I think what customers are realizing, and we see this with the copper to fiber migration, when they move, and they see the speed that they can get on their internet capacity, we're seeing customers upgrade.

And what I've said is we're seeing our legacy copper customers, who we have migrated over to the FiOS network, they are paying between $10 and $15 more in RPU a month after about 60 days on our network, because they're upgrading freely into that 30 and 50 MB per second.

So that's really what's differentiating us in the market. We will continue to advertise around that superiority, and I think that momentum will carry us into the third and fourth quarters.

Mike McCormack - Nomura

Just a quick follow up on the FiOS side. Is there a point at which you guys are going to migrate to an all-IP video network?

Fran Shammo - EVP & CFO

Obviously we've already started that with the copper to fiber migration, but that's going to be quite some time in order to deactivate the copper switches and take all that plant and equipment out. We have the plans to do that, but that's not something that's going to be done within this year or next year.

Operator

Our next question comes from Jennifer Fritzsche of Wells Fargo. Your line is open.

Jennifer Fritzsche - Wells Fargo

I did want to ask about prepay. With AT&T doing [AIO] and now with Leap's purchase and Cricket in the fold, and T-Mobile and Sprint obviously having their own brands, is there any interest on your part in launching an independent prepay brand under Verizon, separate from Verizon?

Fran Shammo - EVP & CFO

I think from a prepay perspective, we are very happy with how we approach this market, between our own prepaid product, which obviously you've heard me talk about in the past, which is just strictly on our 3G network. We do not offer prepaid on the 4G LTE network.

And as I said, we will become more aggressive over time in the prepaid market on that 3G network. Because again, as we look at the 3G versus the 4G, and we move 3G customers into our 4G network, we want to make sure that we keep that 3G network as full as possible, because when you think from an investment return, we're not investing any more in that network, and the fuller we can keep that network without detrimenting the service, the contribution margin of that network is very, very high.

So prepaid is really the pillar of how we will continue to utilize that 3G network, so you'll see us become more aggressive around that when we need to be. You saw us change some pricing in the last two quarters around prepaid, and that has stimulated some growth for us.

And then as I said previously, our other path is through resellers for the lower end market. I don't see the need, at this point, to do a secondary brand around the Verizon Wireless network. We have built our brand around the quality, the reliability, a superior network. I don't think that a secondary brand helps our overall brand at that point.

The other thing I'll say is I'm not going to comment on anything around the AT&T deal with Leap, but I will put to bed the rumors out there that Verizon Wireless may be interested in that asset. And [hear me], we're not interested in that asset.

Operator

Our next question comes from Brett Feldman with Deutsche Bank. Your line is open.

Brett Feldman - Deutsche Bank

I'm not going to ask you about Leap, but that deal is spectrum-driven, and you guys have indicated that you're starting to deploy your AWS-1 spectrum, and maybe that's happening a little sooner than we thought, although you're seeing network traffic ramp very quickly.

I'm just curious if you can maybe give us a status update on your spectrum portfolio. Do you still feel like you have sufficient spectrum to get to the next auction? Do you still see an opportunity to buy spectrum in the market right now from other carriers? And have you started to think about maybe some supplemental solutions, for example maybe revisiting wifi, as another way to put capacity into your network?

Fran Shammo - EVP & CFO

Around spectrum, we did our AWS deal last year, and that put us in a very good spot for our 4G LTE strategy. We started to launch AWS last year. We started to preposition that. We are accelerating the positioning of the AWS based on my comments before around the usage around wireless. But again, we are very comfortable with our spectrum holdings, and we are in good shape for three to four years.

Obviously we will participate in the auction with the FCC targeted for 2014 around the broadcast licenses. That's something that we will participate in. But we are not under any spectrum pressure.

If you look at our frequencies, and the way we deployed our CDMA spectrum, we can actually take very small slivers out of that CDMA spectrum and reallocate that to our 4G LTE spectrum on a needed basis. And that's where we get into this balancing act between the 3G network and the 4G network.

But we are very satisfied with our holdings for the next three to four years. Obviously we're always opportunistic in spectrum acquisition, and we do actually buy spectrum every quarter. You probably don't see it, because we do little markets here and there.

But look, we're always opportunistic, but at this point, we're satisfied, and there's nothing out there at this point other than the auction that we're concentrating on.

Brett Feldman - Deutsche Bank

And on wifi, anything new there maybe involving your cable partners?

Fran Shammo - EVP & CFO

From a wifi perspective, obviously we always like people to offload when they're in their home on a secured wifi network. You've heard me talk before about wifi networks are not secure in the public domain. They have a purpose for us in certain instances around major sporting events and so forth, but our customers are very concerned about their privacy and security. That's why they ride the LTE network as much as they do.

But we do want offload in certain circumstances, and so that does relieve some of the spectrum. We obviously, just from a utilization standpoint, for people that are in their homes, it's not good and efficient to run off the LTE network. They should shift over to their wifi network in their house. So we do encourage that, but again, not major, massive, public wifi is interesting for our customers, at least at this point in time, from a security standpoint.

Operator

Our next question comes from David Barden of Bank of America Merrill Lynch. Your line is open.

David Barden - Bank of America Merrill Lynch

Just following up a little bit on that, Fran, I was wondering if you could give us a status update on the activities and development that's going on inside that joint innovation entity with the Comcast group, and what progress, if any, is being made on some of the digital content rights stuff?

And then I guess second would be kind of along those lines. Could you elaborate a little bit on your relationship with NFL, and kind of some of the strategy behind that content relationship and if that's the beginning of a series of potential new moves to acquire content?

And if I could, just one quick last one, I noticed the strategic services sales and enterprise were a a little over 6% growth year over year last quarter. They kind of slowed down into the 4% zipcode this quarter. I know overall enterprise has been fairly soft, but strategic services has been kind of a core strength. If you could kind of address that slowdown, it would be helpful.

Fran Shammo - EVP & CFO

Around our joint venture with the cable companies, obviously our [unintelligible] solutions team has been working and defining consumers as to what they want both in the home and outside the home.

And obviously what we're learning is the 4G LTE network plays a very critical role in that. We continue to work with them. We have expanded into 968 Verizon Wireless stores across the U.S., and we have about 2,500 indirect locations, the marketing material, and we continue to showcase these types of products.

But I will say that as we continue to work through this, it's hard for Verizon Wireless to sell a cable product outside of the FiOS footprint, because it's new. And it's hard for the cable companies to sell a wireless product outside the footprint, because of the distribution channels. So as we continue to work through this, we're gaining some momentum here.

But I think the one last point from all this is we're obviously very focused on the content rights. And you come into the NFL agreement, and the NFL agreement we think is just a new way of how content rights can be delivered into the wireless segment. And obviously our strategy is around both type of multicasting a live sporting event, and you saw our comments that the 2014 Super Bowl will be a multicast type event to our wireless customers.

So that's really the breakdown of the wall between what can be delivered in the home and out of the home. And obviously we now have the rights to take some of the NFL live games out of the home and deliver them on the mobile devices.

From a content standpoint, this has to develop, obviously, over time. The other point here around content is we are starting to see where we're getting inquiries from content providers that they may want to pay for their content rather than having the consumer pay. Those models are still being worked, but we'll see where that goes. But I look at that as the old 1-800 number, where the actual vendor pays for the usage, and not the customer. So we'll see how that strategy develops over the course of time.

As far as our strategic services go, we continue to have good momentum in our strat services as we refine exactly what we're doing. We have very good momentum in the Terremark and the Hughes platforms, and around our cloud services.

The slowdown, quite honestly, has been around our PIP exercise, and that is growing, but it's more a price compression within the industry. So we're facing some of that going forward. And we knew we were going to face some price compression around PIP, and we have to accelerate on the other strategic services to outpace that.

So, other than that, we have good momentum on strat services.

David Barden - Bank of America Merrill Lynch

And just to clarify, PIP is?

Fran Shammo - EVP & CFO

IP-based solutions.

Operator

Our next question comes from Tom Seitz of Jefferies. Your line is open.

Tom Seitz - Jefferies

Can you just give us an update on your expectations for VoLTE?

Fran Shammo - EVP & CFO

We're still on course for VoLTE. We will start testing and have our first handset in the market at the end of the year. And then we will probably commercial launch sometime next year. But again, as I've said in the past, the critical piece for us is that we have to make sure that our 4G LTE coverage footprint from a VoLTE standpoint equates to our 3G footprint, because the VoLTE call is not backwards compatible with the CDMA network. So when you establish a call on VoLTE, within our network, if you move outside of the LTE network, you will have a hard drop on that call. And obviously that's not something that our customers would expect from a premium provider like Verizon Wireless.

So we're taking our time here. We will thoroughly test this. But we are on track to commercially launch sometime in the first half of next year. And then taking that out, as I've said, at the end of next year, we are on track to have our first only LTE handset to be able to provide to the marketplace as well. So we're still on track with our VoLTE strategy, but it is a critical one for us to make sure that we get right when we launch.

Tom Seitz - Jefferies

So the implication, though, then, is that the 4G network is going to be essentially everywhere that the 3G network is by sometime in the first half of next year?

Fran Shammo - EVP & CFO

The 4G network is everywhere. As I said in my opening remarks, 99% of the coverage of our 4G network is equivalent to our 3G network. But now we have to go back in and fill in that capacity to make sure that from a voice call perspective, it will hand off, because voice is different than the data piece. So we just have to make sure that a customer who is on 3G today, when they go to VoLTE, they would see no difference in their service from 3G to 4G.

Tom Seitz - Jefferies

Could I just follow up on Dave's question? There were press reports that ESPN was considering subsidizing mobile video consumption. And you sort of alluded to that as well. How soon do you think we'll see a material third party payer model? Is it this year? Is it next? Is it a couple of years out? Can you just sort of frame the timeframe of what you're thinking about?

Fran Shammo - EVP & CFO

I think the big barrier right now is how does the content provider get the value of how many people watch their content on a mobile device to be able to go back to their advertisers in order to monetize that content? And right now that's where the barrier is, and we're working on that. But until that get solved, I think this model will be slow at this point in time.

Now, slow to come, I'm thinking maybe next year. But it's certainly not any time in this year that that model will break through. Because they have to recognize the benefit back to their advertisers to be able to monetize that content into our network.

But it is something that's being discussed. They realize that the linear model will not work as it does in TV in the wireless market. You can't assume that someone's going to pay $8 a sub on 100 million subs, so that model does not work. So we are looking at other models, but the barrier is how do you measure everything to get back to the advertisers for the perceived value on that content?

Operator

Our next question is from Amir Rozwadowski of Barclays. Your line is open.

Amir Rozwadowski - Barclays

Just on the capital expenditure front, on the back of this capital expenditure rise for the year, I wanted to ask how we should think about the capital intensity of the business going forward. It does seem as though your competitors are healthily ramping their efforts to try and improve service quality. Do you feel as though you'll need to continue to put your foot on the gas in order to maintain the quality of your network?

Fran Shammo - EVP & CFO

Well, let's put this in perspective. We've moved our consensus by $200 million to $400 million, so this is not a huge step up in our capital spend. We just wanted to make sure everybody realized that we were going to accelerate some of the 4G LTE.

But as we've said in the past, and if you look at our results through the first half of the year, we continue to really be disciplined around the capital investment across our businesses, but also within the wireline segments. So you see that come down year over year. We expect that trend to continue. So that will offset some of the pressure that we may see on the wireless side.

So I don't anticipate that there's going to be any major accelerations, but again, it's too soon to tell where we're going to come out in '13. I'll talk more about that in the coming quarters, but right now the focus is on this year and it's between $200 million and $400 million increment.

Amir Rozwadowski - Barclays

If I may, we've clearly seen a pickup in terms of your shared data plans. I think you mentioned that it's more than 36% of your subscribers that are on these plans. I was thinking from a strategic perspective, as we've seen increased promotional activities by some of your competitors to try and wean subscribers onto their networks, do you feel as though this is a potential mode in terms of protecting your subscriber base from some of these more aggressive pricing plans that are available in the market? Should we expect to see more promotional activity to try and ratchet this sort of percent of subscribers on shared data plans up in the coming quarters?

Fran Shammo - EVP & CFO

This industry has always been an extremely competitive industry, and obviously some of the promotions around unlimited have been there for the last year, when we launched share pricing. And we continue to take market share, we continue to grow our revenue very strongly.

So look, I mean, Verizon Wireless will do one thing very well. They will compete very well in the market, but we are a balanced company. We will compete, grow revenue, grow profitability, and grow our subscribers.

And at the end of the day, customers make choices not really just on price, but the quality of the network, and that's what we've built our brand on. So quality of the network, consistency of the network, the reliability of the network, the value that we provide to our customers through these shared plans.

And again, will we do promos here and there? Of course. As I said before, we'll launch the Verizon Edge, which will give our customers yet another choice of how do they want to enter onto the best network there. So I think the key here is give our customers choice, and continue with what we've built our company on, which is the strongest network.

Operator

Our last question comes from Tim Horan of Oppenheimer. Your line is open.

Tim Horan - Oppenheimer

Two questions on wireless. Fran, you talked about the fact that your LTE network is enabling you to attract a higher quality customer, which has clearly been the case for a long time with your network. But do you have any evidence on that on maybe credit scores? Are you finding with what you've done on LTE and the shared data plans, are you attracting higher credit quality scores, maybe losing lower quality score customers?

And then secondly, on the shared data plans, can you maybe talk about what you're seeing in terms of customers needing to increase their data buckets or many customers bumping up against headroom? Or do you expect to see an acceleration of that in the next year? Or is it more like two to three years out?

Fran Shammo - EVP & CFO

On the high quality, obviously we give a lot of our customers choice of various price plans and how to enter into our superior network. And of course credit scores have always been a component of that. I won't really get into how we differentiate the credit scores, but obviously you can see that from the growth that we have and the revenue growth that we have, this is not a major issue for us. And we watch this very closely, but we're gaining customers across all aspects of the business, let's just put it that way.

Shared data plan, as far as acceleration of data usage, again, what we see, and if you've experienced this yourselves, we continually communicate with our customers throughout the month as to when they get to their usage, and then when they get up into that 90%, we give them the ability to upgrade through their phone to the next tier.

And we see some very good results from that. Customers are upgrading when they need to. So, again, based on our trajectory of data usage, especially with where we see video going, we continue to see that the uptake in the shared plan will continue, the usage will continue to accelerate, and our revenue growth will be reflective of that.

Michael Stefanski - SVP, Investor Relations

That's all the time we have for questions. But before we end the call, I'd like to turn the call back to Fran for some closing comments.

Fran Shammo - EVP & CFO

Thanks, Mike. I just want to leave just a couple points of emphasis here. Our strategic investments and operational execution drove strong financial performance in the first half of this year. But while we are pleased with the overall performance, we obviously know we have more work to do.

We are committed to driving shareholder value by continuing to execute our strategy and improve on the fundamentals of the business. We are focused on delivering superior customer service and providing the best portfolio of products, along with the most reliable and consistent performing network. Our focus is to capture incremental revenue growth in our key strategic areas while we also transform our service delivery and cost structure.

As always, we will continue to be very disciplined around our capital investments, investing in those platforms for the innovation and the growth of the future. Through this strategy and execution model, we expect to drive incremental cash flow and earnings growth, both in the second half of this year and into the future.

Thank you again for joining us, and everybody have a great day.