Verizon

Verizon Communications Inc.		**Industry view:**	**ATTRACTIVE**
Latest results:	Q3 2011	**Company Rating:**	LOW MED. HIGH
Country:	USA	Risk	
Sector:	Telecoms	Quality	
RIC (Ticker):	VZ.N	Valuation	

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Company Profile - Q3 2011 Results

Q3 2011 results - Good revenue growth, but weak margins & EPS

- Revenues grew 5%; with strong Wireless growth (+9%) offsetting the continued Wireline decline (-1%).
- Wireless revenue growth (up 9%) was from subscriber growth (up 7%) and ARPU growth (up 2%).
  - Wireless subscriber net adds of 1.4m was driven by post-paid net adds (of 0.9m).
  - These results outperformed AT&T, which saw much weaker wireless revenues, ARPU & post-paid subscriber growth - as AT&T lost its iPhone exclusivity and was distracted by the T-Mobile merger.
  - Data revenue growth (up 20%) continued to slow, but remained sufficient to offset declining voice (-2%).
- Wireline revenues (down 1%) were weak in all areas; Consumer, Enterprise and Wholesale.
  - The total number of lines grew slightly (+1%) with strong FiOS growth (+28%), albeit slower than last Q.
- EBIT margins were at the bottom of the 16-19% range that they have been in since 2006. Strong Wireless margins offset negligible Wireline margins. Margins were slightly weak due to a $329m severance charge.
- Free cash flow was strong ($4.9 bn) due to low CAPEX.
- Overall, EPS of $0.49 was at the bottom end of the historical range since 2004 (excluding unusual items), despite significantly lower tax rates (8% to 14%); and fell 9% from Q3 2011 (excluding unusual items).

Note: Comparisons (eg. growth rates) are stated on a year-on-year basis.

Significant recent events

- AT&T has bid for T-Mobile (USA). If successful this is likely to benefit Verizon overall by reducing industry competitive pressures by effectively creating a duopoly, and providing the opportunity to poach customers.
- Verizon Wireless to is to start paying a dividend, which will benefit Vodafone.
- Lowell McAdam is to succeed Ivan Seidenber as CEO of Verizon in 2011.

Investment thesis

Verizon is essentially a utility that has an attractive dividend yield (c. 6%) with a value stock investment profile. A key problem is that it has limited ability to grow revenues, margins, and earnings, and thus grow dividends. This is due to negative industry trends of a maturing telecoms industry & intensifying competition (from many sources); creating a loss of pricing power, commoditisation of services, and Verizon becoming a "dumb pipe". Value is shifting from telecoms networks to the content delivered by them (eg. To Google, Facebook etc….) High dividend pay-out ratios of c. 75% (excluding unusual items), restrict potential future dividend increases.

Verizon has a poor financial track record; since 2000, EPS has declined while DPS has been broadly static. Recently wireless revenue growth has improved with the economy, taking market share and ARPU increases. Industry revenue growth depends each subscriber spending more on the new broadband and data services

SWOT Analysis

Strengths

- Large size (economies of scale are critical).
- Largest mobile player; 32% market share.
- Strong brand. Key assets (licenses & network).
- High dividend yield; but high pay-out ratio.
- Strong recurring revenues & free cash flows.

Weaknesses

- Mature US telecoms market.
- Vodafone owns 45% of Verizon Wireless.
- Static EPS since 2000.
- Slowing revenue growth pressurises margins and puts the focus on cost controls.

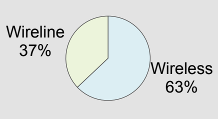
Opportunities

- New broadband services eg. FiOS & LTE.
- Cost cutting; from network sharing, NGN (all-IP network) build & headcount reductions.
- Proposed AT&T / T-Mobile merger.
- Market share gains (from T-Mobile, AT&T …).

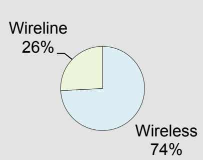
Threats

- Telcos become "dumb pipes", as they compete mostly on price and services are commoditized.
- Margin pressure with increasing competition; from LightSquared, Clearwire, VoIP and WiFi.
- High capital requirements (thus a low ROE).

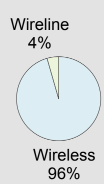
2011 Revenues by Division



2011 EBITDA by Division

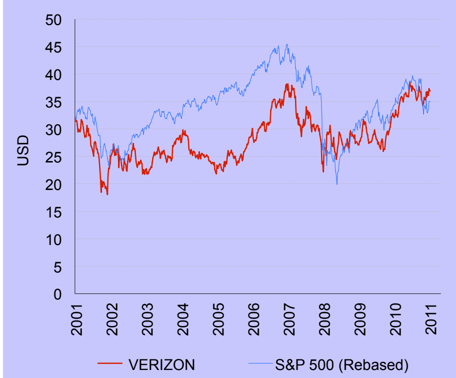


2011 EBIT by Division



Charts are for the period YTD.

Share Price - Last 10 Years



Capital Structure		Per Share ($)	Total ($ Bn)
Share Price		**36.9**	
Number of Shares (bn)			2.8
Market Capitalization			104.4
Net (Debt) / Cash		-16.1	-45.6
Minority Interests & Prefs		-0.4	-1.0
Enterprise Value (EV)		53.4	151.1
Net Debt / Market Cap.			44%
Main Shareholder:			N/A

Consensus Estimates

Financial Results		2010	2011e	2012e
y/e 31 Dec		($ Bn)	($ Bn)	($ Bn)
Sales		106.6	110.7	115.7
EBIT		17.5	19.3	21.8
Net Income		3.7	6.3	7.3
Net Income*		6.4	6.3	7.3
Share Capital		38.6	36.8	37.6
Total Assets		220.0	224.0	224.9
Free Cash Flows		16.9	23.9	7.2
Per Share Data		**2010**	**2011e**	**2012e**
EPS	($)	1.32	2.22	2.57
EPS *	($)	2.26	2.22	2.57
DPS	($)	1.93	1.97	2.01
Cash EPS	($)	5.97	8.45	2.54
Book Value	($)	13.63	13.02	13.27
Efficiency analysis		**2010**	**2011e**	**2012e**
EBIT Margin		16.5 %	17.4 %	18.9 %
Net Profit Margin		6.0%	5.7%	6.3%
Asset Turnover		48.4%	49.4%	51.4%
Net Gearing		570.4%	608.1%	598.8%
Return on Equity		16.6%	17.1%	19.4%
Net Gearing = Net Assets / Share Capital & Reserves				
Growth analysis		**2010**	**2011e**	**2012e**
Sales		-1.2 %	3.9 %	4.5 %
EBIT		25.1 %	9.8 %	13.2 %
Net Income		2.2 %	68.7 %	15.8 %
EPS *		-	-	15.8 %
DPS		1.6 %	2.1 %	2.0 %
Valuation Multiples		**2010**	**2011e**	**2012e**
EV / Sales		1.4	1.4	1.3
EV / EBIT*		7.6	7.8	6.9
P / Sales		1.0	0.9	0.9
P / EBIT*		5.3	5.4	4.8
PE		28.0	16.6	14.3
PE*		16.3	16.6	14.3
PEG		-	0.2	0.9
P / BV		2.7	2.8	2.8
P / FCF		6.2	4.4	14.5
EV / Assets Value		0.7	0.7	0.7
Dividend Yield		5.2 %	5.3 %	5.4 %
Div. Pay-out Ratio		146.4 %	88.6 %	78.1 %
Net Debt / EBITDA		1.3	1.3	1.2

* = Excluding unusual & exceptional items
P = Price; BV = Book Value; FCF = Free Cash Flows

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