Verizon

Verizon Communications Inc.		**Industry View:**	**NEUTRAL**
Latest Results:	2012 Q2	**Company Rating:**	LOW MED. HIGH
Country:	USA	Risk	■ □ □
Sector:	Telecoms	Quality	□ □ ■
RIC (Ticker):	VZ.N	Valuation	■ □ □

INDIGO EQUITY RESEARCH

N. Landell-Mills CFA
Indigo Equity Research Limited
www.indigo-equity-research.com

27 Jul 2012

Company Profile - Gaining momentum

Solid 2012 Q2 results - EPS up 12% with higher wireless ARPU & margins

- **Overall, Q2 results were strong and continued in the same positive direction as previous quarters, driven by Wireless. ARPU growth accelerated slightly to 3.4% (from 1.9%) with higher prices; indicating a less competitive market environment. EBIT Margins jumped to 19.8%, the top end of their historical range since 2006. Verizon continued to outperform AT&T, taking most of the new post-paid subscribers. The key concerns this Q was the continued slowing revenue & subscriber growth.**

- Q2 revenues rose $1.0 bn (+4%), to $28.6 bn, as Wireless growth offset the Wireline decline.
  - Wireless revenue growth (+7%) was from subscriber (+5%) and ARPU (+3%) growth. Subscriber net retail adds of 1.2 m was driven mostly by post-paid of 0.9 m, (+4.2%). Data growth (+18.5%) was strong but continued to slow, while voice fell (-0.1%).
  - Wireline revenues fell (-3%) in all areas except the consumer part of Mass Markets. The number of connections (lines) grew slightly (+3%) with strong FiOS (+29%) and broadband growth (+3%) offsetting the decline in residential lines (-7%).
- **Gross margins up 2% to 62%, suggest lower handset subsidies & network costs.**
- EBIT rose $0.8 bn (+16%), to $5.7 bn. EBIT Margin rose 2.0% to 19.8%.
  - Strong Wireless margins (up 3.6%) offset lower Wireline margins (down 1.2%)
- Net income rose $0.2 bn (+13%), to $1.8 bn, with slightly lower tax rates (down 1%, to 16%).
- EPS rose $0.07 (+12%), to $0.64.
- **Free cash flow was strong again (at $5.4 bn), primarily due to lower Wireless CAPEX.**
- Verizon reiterated guidance for 2012 of double-digit earnings growth.

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

Significant recent events

- Verizon Wireless overhauls its pricing plans - ending an industry price war.
- Verizon agreed to buy Hughes Telematics, for $612 m.

Investment thesis

Verizon is a utility with an attractive dividend yield (c. 5%) and a value stock investment profile. It is a well managed company and is extending its leading position in an oligopolistic market. It takes the best wireless customers, highest overall ARPU, highest margins and lowest churn. Its early deployment of the latest wireless technology (LTE) has positioned it extremely well. **The proposed wireless spectrum purchase from cable companies will increase its lead.** Verizon's operational focus is to stabilize its Wireline business while pushing Wireless growth. As markets mature, mobile growth relies on subscribers spending more on data, to raise ARPU. Vodafone's 45% stake in Verizon Wireless is a major drag on EPS growth as Wireless grows. The high dividend pay-out ratios of over 75% restrict the capacity for dividend increases. **In summary, Verizon is the best of the US telcos, but faces difficult industry dynamics with slowing growth, commoditisation of lucrative voice revenues & tough regulation.**

SWOT analysis

Strengths

- **Large size (economies of scale).**
- **Leading mobile market share.**
- Key assets (licenses & network).
- **Strong recurring revenues & FCF.**

Weaknesses

- **Mature US telecoms market.**
- **45% of Verizon Wireless not owned.**
- High smartphone subsidies.
- Static EPS and DPS in 2006-11.

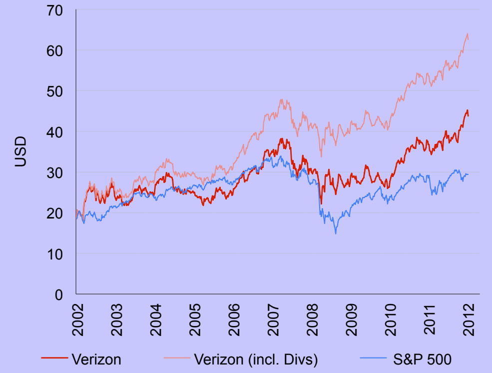
Opportunities

- **New data services eg. FiOS & LTE.**
- Falling wireless CAPEX.
- **Decreasing competition in wireless.**
- **Proposed wireless spectrum purchase.**

Threats

- Telcos become "dumb pipes", as they compete mostly on price.
- **Commoditisation of voice.**
- **Higher tax rates.**

Share Price - Last 10 Years



Fundamental Valuation	($ per share)		
(See Page 26)	**Bear**	**Base**	**Bull**
Valuation	39.1	**47.0**	55.9
Potential Return	-6%	**12%**	33%

Capital Structure	Per Share ($)	Total ($ Bn)
Share Price	**43.8**	
Number of Shares (bn)		2.9
Market Capitalization		125.1
Net Cash / (Debt)	-14.6	-41.6
Enterprise Value (EV)	39.7	113.4
Net Debt / Market Cap.		33%
Main Shareholder:		--

			Consensus Estimates	
Financial Results		**2011**	**2012e**	**2013e**
y/e 31 Dec		($ Bn)	($ Bn)	($ Bn)
Revenue		110.9	115.2	119.1
EBIT		12.9	21.8	23.8
Net income		2.4	7.4	8.3
Capital		36.0	33.0	35.0
Total Assets		230.5	228.0	230.5
Per Share Data		**2011**	**2012e**	**2013e**
EPS	($)	0.85	2.61	2.92
DPS	($)	1.98	2.01	2.07
Cash EPS	($)	4.77	2.32	3.00
BV Per Share	($)	12.70	11.58	12.27
Efficiency Analysis		**2011**	**2012e**	**2013e**
EBIT Margin		11.6 %	18.9 %	20.0 %
Net income Margin		2.2 %	6.5 %	7.0 %
Asset turnover		48.1 %	50.5 %	51.7 %
Net Gearing		640.7 %	690.7 %	659.2 %
ROE*		16.8 %	22.6 %	23.9 %
Net Gearing = Net Assets / Share Capital & Reserves				
Growth Analysis		**2011**	**2012e**	**2013e**
Revenue		4.0 %	3.9 %	3.4 %
EBIT		-12.1 %	68.9 %	9.4 %
Net income		-5.7 %	>100%	12.0 %
Valuation Ratios		**2011**	**2012e**	**2013e**
P / Sales		1.1	1.1	1.1
P / EBIT*		6.6	5.8	5.3
PE*		20.6	16.8	15.0
PEG*		1.0	0.8	1.2
P / BV		3.5	3.8	3.6
P / FCF		9.2	18.9	14.6
Dividend Yield		4.5 %	4.6 %	4.7 %
Pay-Out Ratio		233.8 %	77.1 %	70.9 %
Net Debt / EBITDA		1.2	1.3	1.1

Valuation Ratios are based on the current share price.
** = Excluding Unusual Items*

  Sources: Verizon, Indigo Equity Research

Contents

Verizon

INDIGO EQUITY RESEARCH

27 Jul 2012

Explanations and Definitions

Brief business description - Verizon

Verizon is a large US integrated telecommunications operator, providing fixed line, mobile, internet & IT services. Verizon has a national wireless presence, fixed line presence in 25 states and global data network (ie. MCI). Its main offices are in New York. It has about 190,000 employees and is a component of the S&P 500 index.

Explanation of Company Ratings used by Indigo Equity Research Ltd:

Industry View: **ATTRACTIVE**

Company Rating:

	LOW	MED.	HIGH
Risk	■		
Quality		■	
Valuation			■

Industry View = This is an assessment from an investor's perspective of the potential for the industry as a whole to generate profits in the future based on criteria such as: market structure (eg. number of competitors and industry concentration), growth prospects, maturity (stage of the industry life cycle), regulations, technology, disruptive forces, expected changes and speed of any changes.

Risk = Risk of earnings disappointment & volatility as well as the risk of a change in the valuation ratios (or multiples) that impact the share price. This in turn depends on items such as revenue growth and profit margin volatility.

Quality = Quality of the company to maintain competitive advantages and pricing power, based on criteria such as management, market position, pricing power, market growth, quality of services etc…..

Valuation = Absolute measure of valuation multiples of the company, based on a range of metrics (multiples) such as: P/Sales, PE, PEG, P/BV, P/ FCF, EV/EBITDA, EV/Sales, Div Yield …..

Comment on Ratings: These qualitative assessments of "Company Ratings" are made for each company on a relative basis compared to other companies with large capitalizations.

Financial definitions & abbreviations:

FCF = Free Cash Flow
Op FCF = Operating Free Cash Flow
EBIT = Earnings Before Interest & Tax (ie. Operating Income)
EBITDA = Earnings Before Interest, Tax, Depreciation & Amortisation

12m av. = 12 month average (ie. Average for the last 12 months.)
y/e = (financial) year end

EV = Enterprise Value
P = (Share) Price
PE = Price / Earnings
PEG = PE / Growth

BV = Book Value
Div. = Dividend
EPS = Earnings Per Share
DPS = Dividends Per Share

Explanation of what constitutes an unusual or significant item: Indigo Equity Research determined what constituted "Unusual items" in this report on the basis of assessing what items were significantly or materially separate or different to the Company's core business and activities. This a highly subjective assessment made by the analyst on a case-by-case basis.

Legal and Important Information

Analyst certification: The analyst Nicholas Landell-Mills primarily responsible for the preparation of this research report attests to the following: (1) that the views and opinions rendered in this research report reflect the views of Indigo Equity Research Limited about the subject companies or issuers; and (2) that no part of the research analyst's compensation was, is, or will be directly related to the specific recommendations or views in this research report.

Disclosures: Indigo Equity Research Limited has no investment banking or share trading operations or activities. Reports are prepared at irregular intervals depending on the analyst's judgment. Analysts, associates and members of their households may maintain a financial interest in the securities of companies in the analyst's area of coverage, subject to compliance with applicable regulations. Indigo Equity Research prohibits analysts, associates and members of their households from serving as an officer, director, advisory board member or employee of any company that the analyst covers. Analysts aim to provide appropriate information on companies. Analysts do not provide any BUY, HOLD, or SELL recommendations in their research and the research reports should not be interpreted as providing such recommendations. Indigo Equity Research does not provide individually tailored investment advice in research reports. This report has been prepared without regard to the particular investments and circumstances or investment objectives of the recipient. Securities and other financial instruments discussed in this report are not deposits and are not insured by any institution. (such as the Federal Deposit Insurance Corporation). This report is not intended for distribution to, or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. These disclosures should be read in conjunction with the Disclaimer and Important Information below.

Disclaimer and Important Information: This document has been prepared by Indigo Equity Research Limited for information and illustration purposes only. This document is not an offer, or the solicitation of an offer, to buy or sell a security or enter into any other agreement. This document does not contain an investment recommendation and is not a complete or comprehensive description of a company. Any projections, forecasts or estimates of potential risk or return or financial results are only illustrative and should not be taken as limitations of the maximum possible loss or gain. The information is provided in this document at the date of preparation and is subject to change. While this information has been obtained from sources believed to be reliable, we do not represent that it is accurate or complete and should not be relied on as such. Indigo Equity Research Limited, its directors and employees, can accept no liability or responsibility for any direct, indirect or consequential loss arising from use of this document or its contents. Past performance is no indication of future results. Real results may vary from forecasts. Historic price performance may be presented in a currency other than the currency of the country in which you reside. Your actual return on this product may increase or decrease with fluctuations between currencies and market conditions. The securities and companies discussed in this document may not be suitable for all investors. It is recommended that investors independently evaluate each security, company or instrument discussed in this document, and consult other independent advisors. This document is directed at persons and investment professionals and have considerable experience in matters relating to investments, and equity analysis and research. This report must not be acted on or relied on by persons who are not experienced investment professionals. Indigo Equity Research Limited is not regulated by any financial services authority. This document may not be reproduced, distributed or published by any person for any purpose without Indigo Equity Research Limited's prior written consent.

Indigo Equity Research Limited ("Indigo Equity Research") is registered in England, Company No. 7315966. Address: 22 Abercorn Place, London NW8 9XP, UK. Website: www.indigo-equity-research.com and contact email: info@indigo-equity-research.com.