

Verizon Communications Inc.

Latest Results: 2012 Q3  
Country: USA  
Sector: Telecoms  
RIC (Ticker): VZ.N

Industry View: **NEUTRAL**

Company Rating: **LOW MED. HIGH**

Risk			
Quality			
Valuation			

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## Company Profile - Strong wireless momentum

### Strong 2012 Q3 results - But not as good as it looks

Overall Q3 was strong; revenues rose 4%, EBIT jumped 18% and EPS was up 14%. BUT if you strip out prior year's one-off Severance charges (mostly tied to Wireline), adjusted EBIT\* rose only 10% (which is still good), while adjusted EPS\* declined 4%.

Revenue & EBIT growth was driven by higher wireless ARPU & margins with new data plans (eg. Share Everything), better pricing & stricter handset upgrade policies. This Q, 1.5 m post-paid wireless subscribers were added, which is a significant gain. Verizon is taking post-paid subscribers and market share from Sprint and T-Mobile, as well as outperforming AT&T, primarily due to its lead in LTE network roll-out.

- Total Q3 Revenue rose \$1.1 bn (+4%), to \$29.0 bn.
    - Wireless revenues grew 7%; with 5% more subscribers and 3% higher ARPU. Retail net adds of 1.7 m subscribers was driven by 1.5 m Post-paid & 0.2 m Pre-Paid.
    - Wireline revenues fell (-2%) to \$9.9 bn; despite strong FiOS growth. Mass Markets grew 3.8%, Enterprise declined -3.6%, Wholesale declined -9.2%.
  - EBIT\* rose 10%, to \$5.5 bn. EBIT Margin rose 1.1% to 18.9%; with higher Wireless margins.
  - **Net Income\* fell 3%, to \$1.6 bn despite an increase in EBIT primarily from 25% higher amounts (\$0.7 bn) due to Vodafone; for its 45% stake in Verizon Wireless.**
  - EPS\* fell \$0.02 (-4%), to \$0.56, restricted by 1% additional shares being issued.
  - GAAP EPS rose \$0.07 (+14%), to \$0.56. FCF fell \$3.7 bn (-76%), to \$1.2 bn.
- \* = Excludes additional Severance, Pension & Benefit Charges of \$329 m in Q3 2011.

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

### Significant recent events

- Verizon plans to contribute \$7.5 bn in preferred equity to its pension plan.
- Verizon agrees a \$510m video settlement to TiVo.

### Investment thesis - Strong wireless momentum

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) and purchase of wireless spectrum from cable companies has positioned it extremely well to expand market share. Revenue growth prospects are limited as the US telecoms market matures and lucrative voice revenues are commoditised. Growth depends on the new data services (FiOS and LTE). Vodafone's 45% stake in Verizon Wireless is a major and increasing drag on EPS growth. The high dividend pay-out ratios of over 75% restrict the capacity for dividend increases. Market consolidation, Softbank's investment in Sprint and regulation remain wild cards. In summary, Verizon is the best of the US telcos, but revenue growth prospects are low.

### SWOT analysis

#### Strengths

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

#### Opportunities

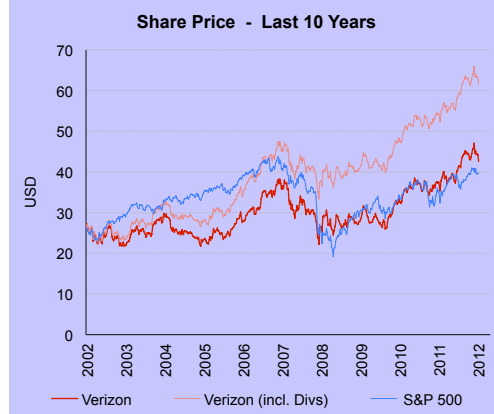
- New data services eg. FiOS & LTE.
- Falling wireless CAPEX.
- Decreasing competition in wireless.
- Wireless spectrum purchases.

#### Weaknesses

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

#### Threats

- Commoditisation of voice & data services; becoming a "dumb pipe".
- Competition from Sprint (Softbank), Clearwire, VoIP and WiFi.



### Fundamental Valuation

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	Bear	Base	Bull
Valuation (\$)	40.0	46.1	52.7
Potential Return	-1%	13%	29%

Capital Structure	Per Share (\$)	Total (\$ Bn)
Share Price	42.6	

Number of Shares (bn)		2.9
Market Capitalization		122.1
Net Cash / (Debt)	-14.8	-42.5
Enterprise Value (EV)	38.3	109.6
Net Debt / Market Cap.		35%
Main Shareholder:		--

Consensus Estimates

Financial Results	2011	2012e	2013e
y/e 31 Dec (\$ Bn)			
Revenue	110.9	115.4	119.5
EBIT	12.9	21.8	24.1
Net Income	2.4	7.0	8.0
Capital	36.0	33.0	34.5
Total Assets	230.5	228.0	230.0

Per Share Data	2011	2012e	2013e
EPS (\$)	0.85	2.45	2.80
DPS (\$)	1.98	2.02	2.07
Cash EPS (\$)	4.77	2.53	2.85
BV Per Share (\$)	12.70	11.55	12.08

Efficiency Analysis	2011	2012e	2013e
EBIT Margin	11.6 %	18.9 %	20.2 %
Net Income Margin	2.2 %	6.1 %	6.7 %
Asset Turnover	48.1 %	50.6 %	51.9 %
Net Gearing	640.7 %	690.9 %	666.7 %
ROE*	16.8 %	21.3 %	23.3 %

Net Gearing = Net Assets / Share Capital & Reserves

Growth Analysis	2011	2012e	2013e
Revenue	4.0 %	4.1 %	3.5 %
EBIT	-12.1 %	69.0 %	10.9 %
Net Income	-5.7 %	>100%	14.3 %

Valuation Ratios	2011	2012e	2013e
P / Sales	1.1	1.1	1.0
EV / EBITDA	3.1	2.9	2.7
PE*	20.2	17.4	15.2
PEG*	1.0	1.2	1.1
P / BV	3.4	3.7	3.5
P / FCF	9.0	16.9	14.9
Dividend Yield	4.6 %	4.7 %	4.8 %
Pay-Out Ratio	233.8 %	82.4 %	73.9 %
Net Debt / EBITDA	1.2	1.3	1.1

Valuation Ratios are based on the current share price.

\* = Excluding Unusual Items