Verizon

Verizon Communications Inc.

Latest Results:	**Q3 2013**
Country:	USA
Sector:	Telecoms
RIC (Ticker):	VZ.N

Fundamental Valuation:			**$57.3**
Indigo View:			**Upside potential**
Industry View:			**Neutral**
Company Rating:	LOW	MED.	HIGH
Risk	■		
Quality			■
Valuation		■	

INDIGO EQUITY RESEARCH

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

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Company Profile - Wireless momentum continues

Strong Q3 2013 Results - Verizon continues to execute

Q3 Revenue grew 4.4%. EBIT* Margin rose 2.4% to 22.6%. EPS* fell 1.4% to $0.68. Revenue growth remains relatively stable at c. 4%; driven primarily by 7% Wireless growth. In turn, Wireless was driven primarily by 5% more wireless post-paid connections and 7% higher post-paid ARPA. Whereas, Wireline revenues continued to deteriorate, falling 1%. EBIT margins rose mostly due to higher wireless margins and a small profit in Wireline. GAAP EPS benefited from a $0.3 bn gain on spectrum sale this Q.

In summary, Verizon continues to execute well extending its lead over AT&T Wireless; winning the lion's share of new post-paid subscribers; While benefitting from the growing demand for wireless data services with adoption of smartphones & tablets. The proposed purchase of Vodafone's 45% stake in Verizon Wireless with equity and debt will raise debt levels & focus Verizon on debt repayment in future.

- **Q3 Revenue rose $1.3 bn (+4.4%) to $30.3 bn.**
- **EBIT* rose $1.0 bn (+16.8%) to $6.9 bn. EBIT* Margin rose 2.4% to 22.6%.**
- **Net Income* fell $23 m (-1%) to $2.0 bn, worsened by a tax rate* up 4%, to 16%.**
- **Q3 EPS* fell $0.01 (-1.4%) to $0.68; Q3 GAAP EPS rose 40% to $0.78.**
- FCF after dividend payments improved $5.5 bn to $5.4 bn.

** Excluding Unusual Items (prior year $0.4 bn loss and $0.3 bn gain this Q)*

Comparisons (e.g. margins changes & growth rates) are stated on a Year-on-Year (YoY) basis.

Significant recent events

- Verizon makes a massive $49 bn bond sale, to fund its deal with Vodafone.
- Verizon acquires Vodafone's 45% stake in Verizon Wireless for c. $124 bn.

Investment thesis - Dominant position but unclear long-term prospects

In short, Verizon is highly cash generative and the best managed & positioned US telco. Verizon is a utility with an attractive dividend yield (c. 4%) and a value stock investment profile. The dividend pay-out ratios are high (>75%); but low gearing provides financial flexibility. Growth & profits are driven by wireless data services (eg. LTE) with consumers adopting tablets & smartphones. Wireline is barely profitable and in decline due to broadband competition from cable, despite FiOS & converting the 'last mile' to fibre. Vodafone's 45% Verizon Wireless stake was a drag on EPS. Key other problems include: a maturing US telco market, commoditization of lucrative voice revenues, becoming a "dumb pipe" and broadband competition from cable.

Verizon Wireless is well managed and has a leading position in an oligopolistic market. It has the best (post-paid) customers, highest 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.

SWOT analysis - Key current drivers & catalysts

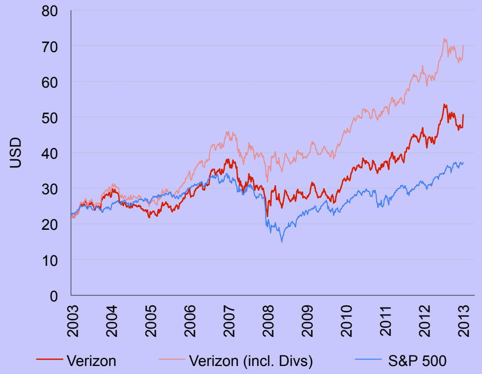
Strengths
- **Large size (economies of scale).**
- **Leading mobile market share.**
- Strong recurring revenues & FCF.

Weaknesses
- **Mature US telecoms market.**
- High smartphone subsidies.
- Wireline is loss making.

Opportunities
- **New data services eg. FiOS & LTE.**
- Increasing margins with higher prices and more favourable wireless data plans.

Threats
- **Increased competition from Sprint (Softbank / Dish?), Clearwire?**
- Apps (eg. WhatsApp), VoIP & WiFi.

Share Price - Last 10 Years



Fundamental Valuation		*(See Page 37)*	
(12 month outlook)	**Bear**	**Base**	**Bull**
Forecast Share Price	$51.2	**$57.3**	$63.9
Return (incl. Div.)	5%	**17%**	30%

Capital Structure	Per Share ($)	Total ($ Bn)
Current Share Price	**$50.7**	
Number of Shares (bn)		2.9
Market Capitalization		145.7
Net Cash / (Debt)	-14.5	-41.8
Enterprise Value (EV)	46.0	132.2
Main Shareholder:		--

Consensus Estimates

Financial Results		**2012**	**2013e**	**2014e**
y/e 31 Dec		($ Bn)	($ Bn)	($ Bn)
Revenue		115.8	120.5	124.8
EBIT*		20.7	24.7	28.0
Net Income*		6.6	8.1	10.6
Share Capital		33.2	35.8	40.5
Total Assets		225.2	227.9	232.9
FCF		11.4	9.7	10.1
EPS*	($)	2.29	2.82	3.69
DPS	($)	2.04	2.08	2.13
BV per share	($)	11.59	12.48	14.13

Efficiency Analysis	**2012**	**2013e**	**2014e**
EBIT* Margin	17.9 %	20.5 %	22.4 %
Net Income* Margin	5.7 %	6.7 %	8.5 %
Asset Turnover	51 %	53 %	54 %
Total Assets / Equity	>600%	>600%	575 %
ROE*	19.8 %	22.6 %	26.1 %

Growth Analysis	**2012**	**2013e**	**2014e**
Revenue	4.5 %	4.0 %	3.6 %
EBIT*	10.1 %	19.4 %	13.1 %
Net Income*	8.3 %	23.2 %	30.5 %
EPS*	7.5 %	23.2 %	30.8 %

Valuation Ratios	**2012**	**2013e**	**2014e**
P / Sales	1.3	1.2	1.2
EV / EBITDA	3.6	3.2	3.0
P / EBIT*	7.0	5.9	5.2
PE*	22.1	17.9	13.7
PEG*	3.0	0.8	0.4
P / BV	4.4	4.1	3.6
P / FCF	12.8	15.0	14.4
Dividend Yield	4.0 %	4.1 %	4.2 %
Pay-Out Ratio	>300%	70.0 %	57.7 %
Net Debt / EBITDA	1.3	1.1	0.9

Valuation Ratios are based on the current share price.

** = Excluding Unusual Items*

  Sources: Verizon, Indigo Equity Research

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 = The risk of earnings disappointment & volatility as well as the risk of a change in the valuation ratios that impact the company's share price. This depends on items such as revenue growth, profit margin volatility, investor sentiment towards the company etc..... But this does not include the market risk of these elements changing.

Quality = The quality of the company reflects its ability to maintain or increase earnings from its competitive advantages, strategy, brand, management, market position, pricing power, services etc…..

Valuation = This is an 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; but are nonetheless subjective and dependent on the analyst's individual opinion & analysis of the company.

Financial definitions & abbreviations:

FCF = Free Cash Flow
Op FCF = Operating Free Cash Flow
EBIT = Earnings Before Interest & Tax
EBITDA = Earnings Before Interest, Tax, Depreciation & Amortisation

TTM = Trailing 12 Months
Last 12m = 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.

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