THE COWEN INSIGHT
On Friday, VZ held a sell-side analyst event at its NYC office. Comments while positive were largely a reiteration of previous things said. Wireless should continue to drive modest growth while a narrowed focus on future 5G opportunities is providing an opportunity today to shrink the cost structure. While we are positive on the fundamental backdrop, we see limited upside to current levels.

Overview
On Friday, Verizon held a two-hour event for sell-side analysts at their offices in NYC that included an update on key areas of the company’s business by senior mgmt. and a Q&A session. Much of the comments made at the sell-side event focused on themes that mgmt. has been highlighting for much of the past few quarters, including (1) a stable wireless environment that is enabling modest albeit improving growth, (2) an increasingly narrow strategic focus centered primarily around future 5G opportunities, and (3) a focus on cost reduction that combined with tax reform is driving strong FCF and debt reduction.

As part of its strategy, mgmt. also continues to message limited interest in game changing M&A – particularly around content – having seen the difficulty others in the space have had thus far, which includes balancing the pivot from linear to OTT as well as convincing shareholders of such a strategy. While one can argue that luck has played at least a part in this considering the fairly open secret at this point that Verizon had been interested in Charter and CBS (see recent John Malone interview linked here), the fact is the simpler/cleaner strategy, at least at this point, is working.

The company also used the opportunity to provide some modest technology-oriented updates on its initial fixed-wireless BB (FW) deployment, although provided no incremental color on economics or the anticipated rate of expansion. While the stock was up on Friday ~1% post the event, much of what we heard was in line with what we believe mgmt. has previously said, albeit it was positive and unwavering. Net/Net: While we are positive on the fundamental backdrop and believe the stock will remain relatively attractive in a “risk-off” market, at current levels we see limited upside. Maintain Market Perform.

Wireless Strategy Should Continue to Deliver Growth
In 3Q18, Wireless Services revenue grew 2.6% Y/Y ex-606 after growth turned positive in 1Q18, with mgmt. messaging it expects momentum to continue. Mgmt.’s wireless strategy consists of the three following things: (1) expanding its unlimited plans to help provide customer choice but also drive ARPU expansion, (2) encourage customers to add incremental devices to their plans including tablets/wearables, and (3) expand its line-up of value-added products that today include Verizon Cloud and Hum. At the same time, the company (and the industry) over the past 5-6 quarters has increased its focus on customer segmentation to drive more targeted/personalized engagement using analytics-driven marketing. This for example has led to new plans (i.e. targeted repricing) for the +55 segment and the military segment. The company also reiterated expectations that it will launch mobile 5G in 1H19 with its first 5G phone being the Motorola MOD/Z3 with other marquee devices expected as well.

Interestingly, mgmt. also noted (and we agree) that unlike previous generational networks that were largely similar across carriers considering the underlying services/devices they supported were similar (i.e. all phones), considering so much of the long-tail opportunity for 5G goes beyond the phone, they believe there will be significant variety among carriers in terms of how they build their 5G networks. To this point, while other carriers are also investing in their networks so they can provide mobile 5G, in our view, Verizon is...
significantly ahead in its investment around fiber/small cells to enable “real” 5G solutions or said differently, those that will depend on real-time connections, and at least initially, will cater to enterprise/industrial use cases. We’d also add that while Verizon said it prefers to own the underlying fiber, they stated “We lease a ton and will continue to do so.”

Fixed Wireless Update Meant to Show Technology Works

Mgmt. showed a well-produced video with customer testimonials that highlighted average DL speeds of ~800 Mbps to 1 Gbps and UL speeds of ~400 Mbps (~10-15 MS latency) and that the service works through foliage/rain. The company also reiterated its intentions to move to the NR standard as soon as it makes sense but that by going early using its own proprietary TF standard it has gained invaluable insights. For example, the company noted early lessons learned using predictive modeling tools and that they have reduced install times by 25%. To this point, mgmt. noted the goal is to ultimately get to a point where customers will be able to self-install. Mgmt. also noted that ~50% of FW customers were not previous customers to Verizon, which they have been surprised by considering the notable discount for Verizon customers, although said there was no uniformity in terms of where they are coming from (i.e. cable or DSL). When asked about returns, mgmt. reiterated that the network is being used not just for FW but will be used to support other 5G opportunities including mobile/IoT as well as fiber-oriented wireline/enterprise opportunities, thus looking at costs on a per home-passed basis or returns on an isolated basis would be misleading. The company also noted it has begun testing mobile 5G including conducting its first 5G NR smartphone data transmission on 11/13/18 in Providence, RI.

Narrowing Focus Reflects Company’s Confidence in 5G

Since Mr. Vestberg was appointed CEO in August, the company has announced a voluntary early-retirement offer for approximately one-third of its employees (expects 10-15% acceptance) and more recently that it will realign its org structure into three customer-facing segments. The changes to some degree reflect a smaller opportunity set under its go-forward strategy as the company pulls back from what historically was a broader market focus that took the company into areas that never fully gained traction (ex: Go90) or previous growth opportunities that have since peaked (ex: SONET) and today represent opportunities to streamline operations and reduce costs. It also reflects the company’s increasing focus on “real” 5G (i.e. non-phone oriented 5G) as the next growth opportunity and its need to break the synonymous view of “enterprise” and “wireline”. To this point, mgmt. noted for example that it will be important to have enterprise customers to upsell/monetize IoT (i.e. “real” 5G), which it views as an advantage vs. others (such as TMUS/S and cable).

This opportunity however is at least in our view still a few years out from being material (particularly for a company of Verizon’s size). As a result, the company is somewhat in a state of in-between and rather than step into a new area of focus (like content), has decided to focus internally on cost reduction and building out said network for the forthcoming “real” 5G opportunity. To this point, it was only in Sept. 2017 that the company announced a plan to reduce costs by $10B by 2021 (of which $1.3B has been recognized through the first nine months of 2018). While this approach is likely in our view to limit the opportunity for material upside to estimates, it also is fairly predictable, which in this market provides a level of comfort that is being highly sought after. Also, while not yet a part of the discussion today, to the extent the company continues to cut into is leverage, it’s possible in our view that as early as 2020 we could see the company in a position to begin returning capital to shareholders in the form a buyback and that this could be an incremental driver of per share growth.
VALUATION METHODOLOGY AND RISKS

Valuation Methodology

Telecom Services:

Our valuation methodology consists of an absolute and relative value approach. We arrive at a fair value utilizing a five-year discounted cash flow (DCF) and when appropriate a segmented sum-of-parts (SOP) analysis. Our relative value approach takes into account EV/EBITDA, P/FCF, and P/E and, when applicable, P/AFFO and dividend yield.

Investment Risks

Telecom Services:

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Risks To The Price Target

Risks for Verizon include: (1) the wireless industry in which Verizon operates is highly competitive and recent industry consolidation could result in disruptive/irrational pricing as smaller carriers seek to gain market share, (2) Verizon’s wireline and business services are reliant to a certain degree on enterprise spending and the uncertain macro-environment, and (3) Verizon continues to grow its dividend and to the extent they were no longer able to do so would have a negative impact on the stock price, while external factors such as rising/falling interest rates could have a negative/positive impact on the stock price.
**stocks mentioned in important disclosures**

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The recommendation contained in this report was produced at November 18, 2018, 20:09 ET, and disseminated at November 19, 2018, 05:30 ET.

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Outperform (1): The stock is expected to achieve a total positive return of at least 15% over the next 12 months

Market Perform (2): The stock is expected to have a total return that falls between the parameters of an Outperform and Underperform over the next 12 months

Underperform (3): Stock is expected to achieve a total negative return of at least 10% over the next 12 months

Assumption: The expected total return calculation includes anticipated dividend yield

Verizon Communications Rating History as of 11/16/2018

Legend for Price Chart:
I = Initiation | 1 = Outperform | 2 = Market Perform | 3 = Underperform | UR = Price Target Under Review | T = Terminated Coverage | $xx = Price Target | NA = Not Available | S=Suspended
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### International Location

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