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VZ.N - Q2 2021 Verizon Communications Inc. Earnings Call

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OVERVIEW:

VZ reported 2Q21 consolidated operating revenue of $33.8b and GAAP EPS of $1.40. 2Q21 adjusted EPS came in at $1.37. Co. raised 2021 adjusted EPS guidance to $5.25-5.35.

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PRESENTATION

Operator

Good morning, and welcome to the Verizon Second Quarter 2021 Earnings Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time. It is now my pleasure to turn the call over to your host, Mr. Brady Connor, Senior Vice President, Investor Relations.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Thanks, Brad. Good morning, and welcome to our second quarter earnings conference call. This is Brady Connor, and I'm here with our Chairman and Chief Executive Officer, Hans Vestberg; and Matt Ellis, our Chief Financial Officer.

As a reminder, our earnings release, financial and operating information and the presentation slides are available on our Investor Relations website. A replay and transcript of this call will also be made available on our website.

Before we get started, I'd like to draw your attention to our safe harbor statement on Slide 2. Information in this presentation contains statements about expected future events and financial results that are forward-looking and subject to risks and uncertainties. Discussions of factors that may affect future results is contained in Verizon's filings with the SEC, which are available on our website.

This presentation contains certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are included in the financial materials posted on our website.

Now let's take a look at consolidated earnings for the second quarter. In the second quarter, we reported earnings of $1.40 per share on a GAAP basis. Reported second quarter earnings include a net pretax gain from special items of $182 million, consisting of a pretax gain of approximately

$1.3 billion related to a pension remeasurement credit as well as a pretax loss of $1.1 billion from early debt redemption costs. Excluding the effects of these special items, adjusted earnings per share was $1.37 in the second quarter.

In May, we announced an agreement to sell Verizon Media to Apollo Funds with an expected close date in the second half of 2021. Upon the announcement, certain assets of the Verizon Media business were classified as an asset held for sale. As a result, we no longer depreciate or amortize these assets, which resulted in a partial quarter benefit of $0.03 per share in the second quarter, and this benefit will continue until the deal closes.

With that, I'll now turn the call over to Hans to take us through a recap of the second quarter.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thank you, Brady, and thank you for joining our second quarter earnings call. It is remarkable, the difference a year can make. We're quickly resuming prepandemic norms. And at Verizon, our network and in-store traffic is almost back to prepandemic volumes, and our office employees are gradually coming back to office.

Of course, some behaviors are changed permanently. The mass shift toward online activity, speed up timeline of work from home, distance learning, banking, entertainment, telemedicine, et cetera. All of these societal and behavior shifts have had an impact on the business. And they reaffirm our Network-as-a-Service strategy and our focus on delivering on our 5 vectors of growth.

Finally, after a year of virtual meetings, I've been spending time in the field with customers and partners, and importantly, with our frontline workers, who have done such heroic work throughout the past year serving our customers. All in all, we have a very enthusiastic and cautiously optimistic stakeholder base.

As we conclude the first half of 2021, I have to say I'm extremely proud of the achievements we have made to strengthen Verizon in all aspects. Let me mention a couple of the milestones.

We strengthened our strategic focus with our divestment of Verizon Media Group, which we believe will close around the end of the quarter. We invested in the best portion of the C-Band in order to accelerate and amplify our multipurpose Network-as-a-Service model.

We have also improved our 2.0 organizational structure, and we brought in a diverse slate of top leaders. Our finance and treasury team did an outstanding job of strengthening our balance sheet with low cost of borrowing and maturity for our debt. We also laid out a long-term financial goal with focus on growth.

All this focus on strategic execution and to deliver profitable growth by our teams have paved the way for a continued great financial performance. And in the second quarter, we not only generated our strongest earnings on record, we also produced good growth and profitability in all our units and segments. We demonstrated continued strength in our wireless service revenue growth. And combined with our scale and operational efficiency, we produced 5.6% adjusted EBITDA growth. Given the strength of our first half results, we are raising our full year guide, and Matt will provide details later in the call.

When it comes to our operations, our recent investments in our customers through the biggest 5G upgrade promotion and innovative trading, coupled with a Mix & Match for both wireless and Fios customers, have led to strong performance across both our offerings.

On the network side, we just continue to offer our customers the industry's best network experience. For the 16th consecutive time, RootMetrics awarded Verizon the best overall network performance. And for the 27th consecutive time, J.D. Power named us the #1 network quality. Our C-Band build, we're on track to build 7,000 to 8,000 sites by year-end, and we're on plan to launch the first 46 markets. And we are also strengthening our network by expanding our fixed wireless access reach.

If we look to the traffic in the network, the customer activity is near pre-COVID levels. And as mobility traffic comes back, we have seen millimeter wave usage increase 290% June year-to-date. And as we continue to deploy millimeter wave sites and we get more device penetration, we expect these numbers to continue to increase fast and track towards 5% to 10% of traffic in most dense urban areas by year-end. We are making progress in executing across all our 5 vectors of growth.

On the 5G adoption, approximately 20% of our wireless phone base are now on 5G devices with a majority of them C-Band-capable. In the second quarter, the step-up rates were very, very healthy, and this reflects value and differentiated experience for our customers. We also had a record high new accounts that opted for a premium unlimited plan.

The next-generation business application, we launched the first commercial available private fiber network solution in the U.S. It's an on-site private 5G that brings on-premise 5G capabilities to large enterprises and public sector customers. The team in Verizon Business Group continued to make very important partnerships. And one of them in the quarter was with Mastercard, where we will work together with Mastercard on 5G mobile edge compute, transforming the contactless payment for consumer as well as small and medium-sized businesses.

The customer differentiation that we continue to develop further strengthened in the quarter when new content and experience to our Mix & Match platform with the broken device trade-in, the biggest upgrade ever promotion, and we also added through partnership, content with Apple Arcade and Google Play Pass.

Expansion into new markets. We have been focusing and continue to have broadband nationwide. And we expanded our 5G Home services, which is now available across 47 markets. On the 4G Home, we expanded to more suburban and urban areas and is now available in parts of all 50 states. At the same time, we launched a new home router, which is compatible with the C-Band. Finally, we have recently expanded our 5G Business Internet also to parts of 42 cities.

In summary, our strategy is working and is more relevant than ever, driving value for our investors and to our customers and society as they embrace new ways of living and working. We have great momentum on all 5 vectors of growth, delivering on profitable growth with alignment to our long-term growth targets.

With that, I'll now turn it over to Matt to discuss the financial results.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Thank you, Hans, and good morning, everyone. Second quarter results were exceptional, both financially and operationally. We continue to execute on our strategy, driving contributions from all 5 growth vectors. We attracted new customers and accounts and delivered low churn amid strong upgrade activity, all of which serves to accelerate 5G adoption in advance of our C-Band deployment later this year.

Accelerating volumes contributed to another quarter of strong sequential wireless service revenue growth, building off our industry-leading performance in recent quarters. At the same time, our disciplined approach is driving profitability and strong earnings results.

Let's go through the details beginning on Slide 6. In the second quarter, consolidated operating revenue was $33.8 billion, up 10.9% year-over-year. Service and other revenue rose 5.7% driven by strength in Wireless, Fios and Media. Equipment revenue rose 47.6% year-over-year, given COVID impacted sales a year ago and was up more than 17% from second quarter 2019 levels driven by healthy upgrade activity.

Total wireless service revenues were up 5.9% year-over-year and 4.0% compared to second quarter 2019. The results represent sequential growth of $139 million, nearly double our industry-leading sequential growth reported in the first quarter. Total Fios revenues were up 5.4% year-over-year driven by continued broadband subscriber growth.

Adjusted EBITDA of $12.2 billion grew 5.6% over the prior year, in line with our service and other revenue growth despite absorbing approximately $60 million of incremental tower lease costs related to the updated agreements to accelerate the deployment of our C-Band spectrum. As Brady and Hans highlighted, adjusted EPS for the second quarter was $1.37, the best on record. The execution of our strategy is translating to record earnings results, and we are well positioned to continue the momentum into the second half of the year.

Now let's review our operating segment results, starting with Consumer on Slide 7. Momentum built throughout the quarter, and we timed our promotions to take full advantage of the economic recovery and increased customer activity. The result was one of our strongest net new wireless account quarters.

With stores fully opened and consumer behavior closer to prepandemic levels, we delivered 1.7 million postpaid phone gross adds in the quarter, up from 1.2 million in second quarter 2020 and almost identical to 2019 levels. Phone churn of 0.65% remained favorable throughout the quarter and benefited from new offers in the marketplace. This result was a record low for a non-COVID-impacted quarter. As a result, phone net adds of 197,000 were our best second quarter for Consumer.

The response to our differentiated customer proposition, including the broken device trade-in and the biggest upgrade ever promotion, was terrific. Device upgrades, which were significantly higher compared to both second quarter 2020 and 2019, drove 5G adoption and step-ups to premium unlimited plans, a strong indicator that our strategy is working. We exited the second quarter with approximately 20% of our phone base using 5G-capable devices with the vast majority supporting C-Band.

In addition, step-up rates were historically high, and nearly 60% of new accounts opted for a premium unlimited plan, a record high. At quarter end, approximately 69% of our account base was on unlimited plans with nearly 27% of our account base on premium unlimited plans.

The quality and reliability of our Fios service, combined with the simplicity of our Mix & Match offerings, continues to drive strong demand for broadband. Fios Internet net adds totaled 92,000 in the quarter, supported by strong customer retention. And our Fios Internet customer base is more than 7% higher than a year ago. Our trailing 12-month total Fios Internet net add performance is the highest since 2015.

Now let's move to Slide 8 to discuss the Consumer financial performance. The improved customer activity translated to impressive top line trends. Total revenue for the quarter grew 11.2% year-over-year and was also 6.7% higher versus second quarter 2019. Equipment revenue was the biggest driver, rebounding above pre-COVID levels from higher activations, aided by our customer value proposition.

Wireless service revenue momentum translated to 5.4% year-over-year growth and 2.5% growth compared to second quarter 2019. Service revenue was driven by customer growth, step-ups, products such as content as well as reseller and prepaid. This growth comes despite minimal contributions from international roaming, which we expect should provide a further uptick to growth in future quarters.

Momentum in Fios continues with revenues of $2.9 billion, surpassing pre-COVID levels, driven by the continued uptake of gigabit speeds. The results represent our highest revenue results ever. We remain encouraged by the continued margin improvement within Fios driven by the adoption of Mix & Match plans and a greater contribution from broadband. Consumer segment EBITDA for the quarter grew 4.9% over 2020, representing an EBITDA margin of 44.3%, down from the prior year primarily resulting from higher activations.

Now let's move to our Business segment on Slide 9. Business wireless activity was highlighted by postpaid gross adds of 1.2 million, up 6.3% over second quarter 2020 and up 2.1% over second quarter 2019. Segment postpaid phone churn was 1.07%, up 17 basis points year-over-year, reflecting elevated disconnects from COVID-related purchases in 2020, particularly within the education vertical of public sector. As schools plan for more in-person learning this fall, we expect disconnects to remain elevated in public sector in the third quarter.

Despite the disconnect pressures, phone net adds were strong at 78,000, with improving trends in both SMB and enterprise, both of which posted their strongest phone net adds in over a year, offsetting the disconnects in public sector.

Let's now move to Slide 10 to review the Business financial performance. The Business segment delivered strong top line growth with total revenue up 3.7% year-over-year. Equipment revenue, which is up approximately 47%, was the primary driver of the increase.

Wireless service revenue growth of 8.0% was driven by strong momentum in small and medium business and the first quarter of enterprise growth since the onset of the pandemic. Public sector continued to show strong growth over 2020, though it was pressured by COVID-related churn in education. The wireless strength was partially offset by declines in Business wireline, which returned to a more normal trajectory after elevated COVID-related demand.

Business segment EBITDA margin was 24.1% in the quarter, down approximately 210 basis points year-over-year, mostly driven by higher equipment volumes and wireline pressure. While pressures likely persist in the near term, the economic reopening, business transformation initiatives and 5G for enterprise provide opportunities to drive margin.

Now let's move on to Slide 11 to discuss Verizon Media Group. Verizon Media Group continued its recent trends and delivered strong performance driven by high customer engagement with our brands and demand for our advertising platforms. Total revenue for the quarter was $2.1 billion, up approximately 50% from a year ago and up 13% from second quarter 2019.

Let's now move to our cash flow results on Slide 12. Cash flow from operating activities for the first half of 2021 totaled $20.4 billion compared with $23.6 billion from the prior year. The change was primarily driven by higher cash taxes and higher working capital requirements due to greater volumes.

The cash tax impact was a result of a one-time benefit received in the second quarter of 2020 as well as a COVID-related postponement of payments in the year-ago period. These expected headwinds were offset by our strong operational results.

Capital spending for the first half of 2021 totaled $8.7 billion as we continued to support traffic growth on our 4G LTE network while expanding the reach and capacity of our 5G Ultra Wideband network. C-Band CapEx was more than $160 million in the first half, and we have placed orders for approximately $1.4 billion of related equipment year-to-date, giving us confidence that we will be within the previously provided $2 billion to $3 billion range for the year.

The net result of cash flow from operations and capital spending is free cash flow for the first half of the year of $11.7 billion. During the quarter, we began to normalize our cash balance closer to the prepandemic levels given the macro environment, and we ended the period with $4.8 billion of cash on the balance sheet, a sequential change of $5.4 billion.

We exited the quarter with unsecured debt of $141.6 billion, a sequential improvement of $6 billion as we continue to focus on optimizing our debt footprint. Our total borrowing costs in the second quarter were $1.4 billion, which was relatively flat to second quarter 2019 levels despite having approximately $40 billion in additional debt this year. Net unsecured debt at the end of the first half was $136.8 billion, and our net unsecured debt-to-adjusted EBITDA ratio was approximately 2.9x.

Now let's review our annual guidance targets on Slide 13. Our strong first half performance and the momentum in our business gives us the confidence to raise guidance. Please note that the updated guidance reflects the planning assumption that the Verizon Media sale closes at the end of the third quarter.

Starting with revenue. We are raising our wireless service revenue growth outlook to 3.5% to 4%, up from the prior 3% plus. The drivers of the revised outlook are broad-based and include positive trends we are seeing for customer acquisition, premium plan adoption, products and services such as cloud and content as well as prepaid and reseller growth.

The anticipated timing of the Verizon Media sale means we would not recognize any revenue from that business in the fourth quarter. As a result, service and other revenue is no longer an apples-to-apples comparison with 2020, and we are withdrawing that growth guidance at this time.

Turning to earnings. We now expect an adjusted EPS range of $5.25 to $5.35, up from the prior range of $5 to $5.15. The increase is driven by the improved wireless service revenue outlook, the aforementioned Media D&A benefit and a reduction in the expected interest expense related to the C-Band investment. Our guidance for the effective tax rate and CapEx are unchanged.

In summary, we're competing effectively and delivering strong volumes, growing accounts, driving healthy step-ups and positioning our base to capitalize long term as we grow 5G adoption. Our customer performance has led to quality financial results as demonstrated by the sequential wireless service revenue growth while also flowing to the bottom line with best on record adjusted EPS. We enter the second half with a lot of momentum, and I am confident we will continue to execute our strategy and deliver strong operational and financial results throughout the remainder of the year.

With that, I will now turn the call back over to Hans to discuss our priorities for the remainder of 2021.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thank you, Matt. At our Investor Day, we laid out commitments for 2021 and beyond to scale our Network-as-a-Service strategy and generate GDP-plus growth. We made transformative investment over the last 12 months through acquisitions, divestiture and customer innovation and creating a strong platform for growth in the second half of 2021 and beyond.

Our priorities for the second half continue to build on our current network and customer initiatives to further amplify and accelerate 5G adoption, further cement our network leadership through industry-leading millimeter wave and C-Band assets. We expect to close our TracFone and VMG transaction later this year, increasing our focus on what we do best and bringing innovation and best-in-class customer experience to the value segment and overall, drive growth across our 5 vectors with discipline and customer-focused execution. At the end, the great transforming first half, we competed very well in the marketplace. And we're very confident and excited on our opportunities ahead.

With that, I turn it over to Brady for the Q&A.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Thank you, Hans. Brad, we're now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Brett Feldman of Goldman Sachs.

Brett Feldman - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

And 2, if you don't mind. First, I just wanted to go back to some of the color Matt was giving on the improved outlook for wireless service revenue growth this year. At the high end, that's actually a pretty significant improvement. I know you outlined a number of things that were behind it. But I was hoping you can maybe just dig into that a bit more. I'm particularly interested in what you're doing to outperform as it relates to plan mix. And then are you seeing a return of any of the fees that had come out of the run rate last year? Is that something you've seen already? Or is that embedded in the outlook?

And then just on the improved EPS guidance, if we just sort of look at the $0.03 benefit you got from moving away from the D&A in Media in the recent quarter, that would imply that the improvement to your outlook this year maybe capture $0.07, $0.08 just from that accounting shift with the rest of it being operational. But if it's more nuanced than that, I think we'd all appreciate that insight.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

I can just start, and Matt will fill in. But I think that on the service revenue, I think you have seen the last 4 quarters right now, I mean, how the team has done a fantastic job to differentiate our offerings all the way to see that our customers are doing step-ups. They are taking the unlimited premium. And as Matt said, I mean, 60% of the new accounts in the quarter was taking unlimited premium, and the penetration of 5G is happening.

So we just continue the team with Ronan on the Consumer side, if we talk about that, they have this model, we have had it for several years, where we do the Mix & Match. We have a differentiation, and it's clearly resonating in the market. And at the same time, we see, of course, the economy coming back. The stores are getting almost back to prepandemic.

So all in all, it's a good timing for us, and that's also why we feel good about our guidance and how the service revenue grow -- growing. And remember, we are always focused on profitable growth. That's what the team is doing.

And if Matt and I see opportunities, we support the team to do it. But as long as it's going to be a profitable growth. And that's what we are seeing right now with all the momentum in the market. The team is taking advantage of that, and that also translates back to the guidance. But all in all, I would say this is our strategy we've been having for a couple of years and has been very successful. Matt?

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes. Thanks, Hans, and thanks for the question, Brett. So starting with the question about wireless service revenue growth. And as Hans mentioned, it's really building on the momentum that we've seen in the first half of the year, the continue -- continuation of the sequential service revenue growth. We saw that the prior couple of quarters. We saw that increase even further in the second quarter. We expect that trend to continue as we get into the second half of the year because of the operational momentum that Hans mentioned, more step-ups to higher-priced plans, et cetera, et cetera.

In terms of the fees, obviously, the year-over-year component is rather unique this time as second quarter last year was the most heavily impacted by COVID. And more specifically, for us, of course, we had the Keep Americans Connected Pledge that was in place for all of the second quarter that, as you said, impacted some of the fees. As you think about the numbers this year, a good chunk of those are back in. We're more at a BAU level.

A couple of items, though, that aren't in the numbers yet. Obviously, international travel is not back to anywhere close to prepandemic levels. I don't expect that to be there for the balance of this year. Expect -- hope there will be a tailwind as we get into next year, but the guide doesn't make any assumption about an acceleration of a return of those fees in the second half of '21.

One other thing I'd draw attention to as well when you look at our numbers and you think about return of fees, one of the things that's been very strong in the first half of the year is customer payment patterns, which is a great thing to see. And certainly, with all the stimulus payments out there, there's a lot of money in the system, and customers are actually paying more frequently.

So even though we're back to normal in terms of things like late fees, we're actually charging significantly less than we were in second quarter of '19 because more of our customers are paying on time at this point, which is certainly a trend that we're very happy to see. So some of the fees are back, but not all of them are back when you think about it. And we're not assuming they'll be back in the -- for the balance of the year.

The guide is based off of the strong operational momentum in the business, customers stepping up to those higher-priced plans. And we see that momentum continuing.

Your second question about the EPS guidance. And obviously, glad to be able to raise the guidance. That's based off having a very healthy business that is performing exceptionally well. As you mentioned, some of the upside to the guidance comes from the Media depreciation and amortization, probably about $0.06 to $0.08, depending on the timing of the close. But the majority of it is coming from cash items, whether that be the wireless service revenue guide we were just discussing but also related to improved expectation around cash interest expense, lower than anticipated at the start of the year.

So most of the guide is driven by cash-related items. And that's, of course, based off the strong momentum you see in the business, both operationally and financially.

Operator

The next question is from John Hodulik of UBS.

John Hodulik - *UBS Investment Bank, Research Division - MD, Sector Head of the United States Communications Group and Telco & Pay TV Analyst*

Just a question on the upgrade rate. Obviously, it's up, not just year-over-year, but even over the '19 levels. Do you expect that trend to continue and maybe even accelerate as we move into the second half of the year?

And then if you could comment on the impact on margins, I would imagine that it helps incentivize people to move into those higher-priced premium plans, but the higher mix of equipment revenues may put pressure on margin. So just how you foresee the sort of margin trends in the second half as these volumes build would be great.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Yes. I mean, as I said before, I mean, we have this formula right now that we had for -- since we launched unlimited, with both Mix & Match and then our value proposition that we have done. And you saw in the second quarter that now we added also gaming with good traction with both Google and Apple gamings. And this is a unique model for us. At the same time, of course, we have excitement around 5G, what we have, and our network is performing extremely well.

So I think that our team, they have a very, very good model for continuing this. And I think I said it in the first quarter, there will come more of this value proposition and differentiation. And yes, it came. We went into gaming.

So I say it again. I have a lot of confidence in the team and Ronan's team to continue to come up with things that our customer loves and using our distribution, our network and the brand to continue to grow this. And then, and that is the whole strategy.

And remember the 5 vectors of growth, we are playing all 5 of them. And that's why we're also confident of our long-term guidance are done, and you see part of that in this quarter, that we already are executing on all of these vectors.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

John, so as you mentioned, obviously, the higher mix of equipment revenues shows up in the margin percentage. But I think you also have to look at the margin dollars, which were up sequentially and also up significantly year-over-year. So very happy with that performance at the margin line.

As you say, once we -- when we have a higher equipment revenue, it has an impact on the margin. But I like the combination of volumes and margin that we had in the second quarter. As we head to the second half of the year, with the outline of our -- the offers we have in place that Hans mentioned, combined with new devices coming into the market as we get closer to 5G launch, the underlying strength in the economy, I would expect that we will see good equipment volumes in the second half of the year. And I would also expect to see good EBITDA dollars in the second half of the year to go along with that.

Operator

The next question comes from Phil Cusick of JPMorgan.

Philip Cusick - *JPMorgan Chase & Co, Research Division - MD and Senior Analyst*

Two, if I can. Consumer wireless broadbands were strong. Did home broadband drive that? And how many home 4G, 5G customers do you have now?

And second, a lot happening in MVNO land these days with Boost going after AT&T after they couldn't -- cable away last year. Did you look at that deal? How do you think about the potential for new competition from all these channels?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thanks. When it comes to broadband in general, I will start with our vision, as we have outlined, we want to be nationwide broadband provider. And we're going to use access technology that is best suited for our customers in the mix of everything from fiber to 4G to 5G, millimeter wave, C-Band and all of that. And this quarter, so we open up even more opportunities for that.

We open more 5G Home markets. We open more 4G Home markets. And then, of course, as Matt outlined as well, we took more Fios subscribers than ever in the last 3, 4 quarters.

So this is playing out well for us. We're opening up all of that. We are very excited about what's going to happen in the second half with the new CPE that has C-Band as well. So we executed everything we said we should do in the Investor Day in the second quarter, and we look forward to the second half of this year. And we will continue to report out what we're doing.

The second question, I think that, I mean, we are open for business, but we don't comment on any particular deals in the market or something like that. But we are happy with the customers we have on our MVNO.

Operator

The next question is from Simon Flannery of Morgan Stanley.

Simon Flannery - *Morgan Stanley, Research Division - MD*

Just a quick one on TracFone, you said closing in the second half of the year. Any more color on the process or more timing expectations would be great.

And then on the C-Band, I think you said previously, you wanted to deploy about 7,000 to 8,000 towers later this year. I see you reiterated the CapEx guide. But any color on getting the equipment supply chain and the ability to hit those targets in terms of rolling out? And any updates to your longer-term targets of 175 million on C-Band, how are you thinking beyond that?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

So on the TracFone, I think nothing has changed since we outlined or we proposed the acquisition. It's tracking according to plan with the process that we need to go through. The team is responding to all the questions we have. So it's going to be in the latter part of the second half of the 2021 as we thought all the time. So nothing strange. It's actually on track, but that's where we are. Second question was...

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

C-Band.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

C-Band, yes, the 7,000 to 8,000 sites. Yes, we can definitely say we're on track. When we reported the first quarter, we had just started everything. Now we feel we have a full funnel in the supply chain. We -- the guys in our supply chain done a great job with our partners. We have all the gears we need to deploy the 7,000 to 8,000 and then our team executing very well. So we feel very good about being able to have 7,000 to 8,000 sites up by year-end.

And when it comes to the long term, I mean, we have the same ambitions as before. We haven't changed those, and we continue to execute. So we will do it as fast as we can, given the different type of milestones that are involved in the spectrum. But as so far, we are executing on that plan, and we are on or ahead of the plan of executing right now for the end of the year.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes. Simon, one other data point for you. The vast majority of the radios that we need to turn on those 7,000 to 8,000 sites are already sitting in our warehouses. So the supply chain is robust, working very well with our partners. And obviously, a lot of work still to do. But the network team, from where we were in March after we came out of the auction to where we are today, they did have plans in place, and they're executing strongly against it. So...

Simon Flannery - *Morgan Stanley, Research Division - MD*

And the spectrum clearing is working okay?

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Spectrum clearing is also on track. I mean we stay close with the folks doing -- everything we hear from them is that's completely on track as well.

Operator

The next question comes from David Barden of Bank of America.

David Barden - *BofA Securities, Research Division - MD*

In the first quarter, you guys talked about how the second half of the year would be an improvement for Verizon in the Consumer business. We've seen, obviously, some of the new promotions come out. Margins have drifted down to the 44% range.

Does Ronan have permission from you, Hans, to take that down further if you see some more gains opportunistically in the second half with either the current kind of 5G handset upgrade promotions or new stuff coming down the pipe?

And then the second question is, consumer cost of service has been up pretty significantly for the last couple of quarters relative to the past year. Is that related to C-Band prepositioning? Or is there something else going on? And what's the outlook for that?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

When it comes to the Consumer group, and Matt explained a little bit why the margin is lower because the hardware part of it is included there. And we think that's a -- it's a good sign of what's happening in the market.

I would say that, I mean, we constantly think about profitable growth, and that has been our strategy as long as I have been here. And Ronan and team, they think about that. But of course, if they see an opportunity, as we saw when the traffic came back in the stores and the economy is coming back, we did some offerings in this quarter, which was good timing. And we will continue to support Ronan where we see he has a good solution for the market and our customer going to love it.

I can tell you, our differentiation is really resonating with the market, and that's what you see in the second quarter. And we will come back and see if there's something he wants to do in the second half. But clearly, we're focused on profitable growth, and we want to have -- we are writing high-quality business in high quantity. That's what we want to do. And I think you see that coming through in these results.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes. So just adding to that, Hans. So obviously, the margin percent will be impacted by the volumes. We saw good volumes in the second quarter. But what -- as Hans said, what we're focused on is if you also look in there, sequential service revenue growth continue to lead the industry in that because not all net adds are created equal. And that also coming with EBITDA dollars increasing.

So the margin percentage will play out where it does based off the volumes. But we're focused on -- you're seeing that sequential revenue increase and also the EBITDA dollars flowing in the right direction.

In terms of your question around the cost of service, predominantly in Consumer, don't forget one of the items that we had in the second quarter was a step-up in the network rent and lease of about $60 million a quarter as a result of the new lease payments we put in place. As you know, under the accounting, you look at the total payments over the life of the lease and kind of flatline it irrespective of how the natural cash flow payments flow.

So there was, obviously, a significant upgrade to our lease agreements. And that was a onetime step-up in the quarterly rate there that flowed through the books at, say, about 60 -- $60 million, close to $0.01 a share impact from that. That should be the same going forward now. So that's the biggest driver you're seeing on the cost of service.

David Barden - *BofA Securities, Research Division - MD*

And so, Matt, just maybe a follow-up on that.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Okay. Go ahead. Go ahead, Dave.

David Barden - *BofA Securities, Research Division - MD*

So just -- that's all in Consumer?

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

The vast majority of the wireless network costs are allocated to Consumer. Some of that is in Business, but the majority is in Consumer. Obviously, the majority of the customers, the majority of the wireless service revenue is in Consumer. And so the costs are going to be allocated largely in line on a similar basis to that. So yes, most of it is in Consumer.

David Barden - *BofA Securities, Research Division - MD*

And then probably worth noting that then your EPS guidance includes negative $0.03 for the 2, 3, 4Q impact of that increased tower expense?

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Absolutely, that's fully baked into the guidance, that step-up in that cost. So that comes back to the underlying strength of the business that we have even with that baked in as well.

Operator

The next question comes from Michael Rollins of Citi.

Michael Rollins - *Citigroup Inc., Research Division - MD & U.S. Telecoms Analyst*

I'm curious what you've learned during the pandemic and now the reopening about where customers want to transact for wireless, whether it's upgrading phones or changing service providers. And are a large portion of wireless transactions simply destined to remain in physical locations versus a virtual or online channel?

And then just a follow-up. You mentioned a number of markets that you've been focused on for Ultra Wideband and 5G Home. I'm just curious if you could share some population and household coverage numbers for Ultra Wideband and Home for the end of '21 and the target for the end of '22.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Thank you. Now, of course, we see some changes in behavior when it comes to our customers. But we had already started building our omnichannel that our customer can start on the web, and they can end in the store or they can start in the store and end on the phone and all of that in order to see that we do this as seamless as possible.

But clearly, we see much more digital than before. But also when the economy came back and the vaccinations in the United States were coming up on high levels, we also saw the traffic coming back in the stores. And so we have had, I would say, all our stores opening in the second quarter. And we see much more foot traffic than we have seen in the previous quarters, not really back to prepandemic days but clearly fairly close.

So we think our customer is still going to want to come into a store and see our technology and our products, but they might be wanting to finish the delivery and the purchase in a digital fora. And that's how we build our stores.

So we are working very closely to see that the new behaviors that we can meet, that's why so our customers really feel good about dealing with us. And I think that our team are doing a great job in that area.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes, Mike, in terms of your question around the millimeter wave coverage, we don't really talk about the millimeter wave coverage in terms of POPs. You heard Hans mention upfront that we're on track to seeing 5% to 10% of dense urban usage on millimeter wave by the end of the year. That's a combination of more customers having 5G devices in their hands, customer activity moving back to more prepandemic levels and then obviously, building out more millimeter wave sites.

We said we would do 14,000 sites this year, be at over 30,000 by the end of the year. I can tell you we are running well ahead of schedule for the 14,000 sites through the first half of the year. And so as we do that, we continue to add coverage. And then we said we'd expect to cover 1 million to 2 million homes with millimeter wave open for sale by the end of the year, and we're on track with all of those items.

Michael Rollins - *Citigroup Inc., Research Division - MD & U.S. Telecoms Analyst*

Any early look to 2022?

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

The build continues to -- obviously, we're not going to give guidance for 2022, but everything the network team is doing, whether on millimeter wave, whether on C-Band, and remember, we said we'd be at around 100 million POPs by -- during the first quarter next year. And we expect -- still on track to be at that level.

So at this point in time, I can't speak more highly about the work the network team is doing as they build, whether it's the fiber that, obviously, is important to the network, the millimeter wave expansion, the C-Band expansion and continuing to have the best 4G network out there as well. So they're doing a tremendous amount of activity, and they continue to be on both our 2021 plans and our longer term plans, too.

Operator

The next question comes from Craig Moffett of MoffettNathanson.

Craig Moffett - *MoffettNathanson LLC - Co-Founder, Founding Partner*

Two quick questions. First of all, I want to return to a question that Phil asked. I didn't hear the discussion. Can you talk about the DISH wholesale deal with AT&T, what your observations are and whether you were part of that negotiation? And then separately, if you could just comment on whether you saw any significant impacts from the EBBP program during the quarter, either in your wireline business with Fios or your wireless business?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Hey, when it comes to specific deals in the market, we don't comment on that. And apparently, this is something that AT&T won from T-Mobile. So I cannot comment our involvement in it or not.

But as I said, we are open for business. We have a Network-as-a-Service strategy model, which is paying off well for us with the 5 vectors of growth. And part of that is monetization of MVNOs, and we are very happy with what we have.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes, Craig, to your second question, we saw some of our customer base certainly participate in that during the course of the second quarter. I wouldn't say it was a significant impact in our numbers, but we did certainly see our customers participating.

Operator

The next question is from Doug Mitchelson of Credit Suisse.

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Douglas Mitchelson - *Crédit Suisse AG, Research Division - MD*

Two questions for me as well. I mean, first, AT&T moved to 30- and 36-month handset EIPs periods this quarter, and your churn is even lower than theirs. So your customers stick around even longer on average. Have you thought about going longer than 24 months? And if not, why is 24 months sort of the right period?

And I'm just really curious on C-Band as we try to figure out how to model 2022, and you get the licenses cleared and you flip the switch and light that up for customers. As you go into 2022, how's your go-to-market strategy changed, if at all? And what do consumers sort of see in terms of their experience that's going to be materially different? Obviously, it was a big investment, and I'm just sort of thinking through on a practical basis what happens as that starts to kick in?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Yes. Now I can start with the C-Band. For obvious reason, we think it's an important moment. We are both amplifying and accelerating our 5G in the network, amplifying the opportunity. However, giving away our commercial ideas at the -- when we're going to launch this right now, we wouldn't do that. But of course, we're excited over it.

We think it's going to be great for our customers. It's going to be fantastic performance, and it expands our 5G mobility options, our 5G fixed Fios access options, and it also extends our 5G mobile edge compute options. So it's just playing straight into our -- to our strategy. So we are excited over it, and we will come back, how we will bring that to our customers. So they are equally delighted as they are with our network today, but just getting something that is so much superior than anybody else.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes. Hey, Doug, on your first question about the handset device payment period, we're very comfortable with the offers we have in the marketplace. It's 24 months for a lot of items, some of the higher-priced items, it's a little bit longer just to manage that. But as you mentioned, the churn is very, very strong, 0.65% in Consumer for phone churn shows that what we're doing with customers is working very, very effectively. If we feel the need to adjust it, we will do so, but it will be based off of what we see customers need and not be focused on any impact on the accounting treatment associated with it. So we will continue to be focused on finding the right offers for our customers. And I think you see from the results in the second quarter, what we're doing is resonating with customers, both from an adds standpoint and also a churn standpoint, too.

Operator

The next question comes from Peter Supino of Bernstein.

Peter Supino - *Sanford C. Bernstein & Co., LLC., Research Division - Research Analyst*

A couple of related questions. The first is one of your competitors has talked repeatedly about the network capacity improvements that come from 5G. If you adjust that company's target for M&A, you could infer that their capacity is up about 7x for their 5G expansion. And so I'm wondering if you could suggest a similar number for Verizon's capacity and growth potential considering the wonderful investment in the C-Band.

And then on a related note, as it relates to the Home business, I'm curious if you could describe how you think about allocating the cost of spectrum

(technical difficulty)

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Okay. On the first one, on the -- if you have been listening to what I've talked about around 5G before, first of all, 5G as a technology is better to handle data than 4G, and that's obvious. 3G (sic) [4G] is better than 4G (sic) [3G] as well. So that's happening.

Then you need to add, too, that you're not only talking about spectrum, you're talking about how you engineer and how you build the network. So in our case, of course, we see great opportunities for being able to handle much more data.

And remember, I mean, today, on the millimeter wave, we might use 400, sometimes 800 megahertz, but not more. And we have 1,600 megahertz nationwide. So there's so much more we can do. And as Kyle showed at the Investor Day, our headroom in the network is bigger than before, and that's before we start building what we're building right now.

So we feel really confident how much -- how many x we are doing. And remember, I mean, our 4G is already the best in the nation. And then we're adding up right now what we're doing in 5G, that is also extraordinarily good. So others can talk and we usually execute, and we will continue with that.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

So Peter, on the second part of your question about allocating cost of the spectrum, I'd reframe that and actually view it from the standpoint of this is the first time that we've had wireless technology where we can drive multiple revenue streams off of the same network build, whether that be the mobility, which has obviously been the foundation of 4G, 3G and everything since the start of wireless. But then the ability to also have fixed wireless access, to also have the public mobile edge compute, all coming off of that same network build, that same network investment, we think, gives us the opportunity to provide a very good return on the investment that we've made in both C-Band and millimeter wave.

Operator

The next question comes from Kannan Venkateshwar from Barclays.

Kannan Venkateshwar - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

A couple, if I could. Firstly, on the nonpay churn front, obviously, that I think you guys noted the benefit because of some of the subsidy programs. But at some point, that will probably reverse for the industry as a whole. So could you help us understand how big of an impact that typically is in a normalized year, nonpay churn and how much of a tailwind that is right now to get a sense for what that might do when things normalize?

And then secondly, I mean, you have a lot of content bundles now. You also have the new deal with Apple Arcade. Could you give us some sense for how this impacts your cost of service? I mean how much of the increase in cost of service is on account of this? You did quantify the lease number, but it would be good to get some sense for what this is doing overall to cost versus ARPA kind of trends.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

I can. Matt will talk about nonpay churn. When it comes to the content deals, I mean, I think I've said it a couple of times now. I mean our whole idea is to offering exclusive offers for our wireless customers. And we also want to offer that partnership to brands that we really think resonate with us.

And the model, as we have spoken about before, is that this is incremental revenue for us. It's not only loyalty. It's actually incremental profit for us. So it's a totally different model that might sometimes not been in the market before because suddenly, we use the best network, the best distribution and the best brand to work with companies like Disney+, et cetera, to give our customers a premium experience on top of the differentiation we already have with the Mix & Match.

And ultimately, when we make this customer to paying customers, we get our fair share of that because we, with our assets, have created it together with the asset for Disney+, Discovery or gaming, et cetera. So that's how the model is working. And as I said before, we are very pleased with the -- with, I think, we have 6 or 7 of these offerings in the market right now, and all of them are very positive to us and to our customers. And we will continue to see if we can find more. And I think it's a unique model that we have created that nobody else has in the market.

And I said, again, it goes back to Ronan and the team being very, very innovative and creative to see that we bring the best to our customer, not only the best network, but also the differentiation in offering. So I have to say I'm very pleased with that. And I said, we have more in the funnel.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

And Kannan, on your other question around the churn, I would say it's a very small number of basis points of benefit coming from the reduction in what we call involuntary churn. And what you're also seeing in the total churn number is actually the benefits of the engagement with the customer, the experience the customer has on the network, the other experiences we bring to that relationship that Hans has touched on being a bigger piece of the strength in the overall phone churn number that we reported, especially on the Consumer side.

And in terms of the impact of cost of sales, obviously, the content cost associated with the items that Hans mentioned do flow through there. And you should expect to see that number continue to be a contributor of that line.

But when we look at the overall profitability of bringing that together, the overall customer proposition, it's EBITDA additive to the business and also brings a better experience to the customers. So we see that as a win-win.

Operator

Your last question is from Colby Synesael of Cowen.

Colby Synesael - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Two, if I may. First off, on business EBITDA margins. At your Analyst Day back in March, you had guided to sustaining north of 25%. And we saw that below that in the second quarter, also in the first quarter although there's that onetime impact. And it sounds like you're guiding for that to continue to be below 25%.

I'm just curious what's changed so quickly that you're targeting below that target, at least it looks like for 2021? And then also as it relates to the biggest upgrade ever promotion, when we look across the space competitively, obviously, AT&T has been doing something similar since the fourth quarter. Even T-Mobile did something just yesterday.

Do you really look at this as a promotion and implying at some point, there is an expiration and you pull that from the market? Or is this really just the new way of competing in today's competitive market and really something that investors should assume in some form or the other is going to be with us for a long period, if not permanently?

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

I can make a quick answer on the promotion, and Matt will come back. We have already pulled the biggest 5G upgrade from the market, that we did.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Today. Today is the last day.

Hans Vestberg - *Verizon Communications Inc. - Chairman & CEO*

Today. Yes. So yes, we see it as coming in and out when it's the right moment, but Matt will probably comment a little bit more on it.

On the Business side, I mean, in Q4 2018, Matt and I talked about that. We think that this is one of the great opportunities we have over time with the Business side. And remember, we have never consolidated our Business side. It was compartmentalized in between all the different business we have.

Tami and the team have during that moment -- and remember, we said we're going to invest in order to see that we have the platforms of products of CX and UX for our customers to be harmonized in order to be able to scale this to be a good business. And that they are doing, and they probably are halfway through it. They're doing a lot of transformation in the business.

At the same time, there are some headwinds as we have seen before. I mean that would be the wireline sort of cyclical or -- no, it's not cyclical. It's a sustained decline. And then we have a wireless business where we take more than our fair share. We are leading in all segments. And that balance, of course, is coming into this quarter. Of course, we had more hardware this quarter as well.

And then we're building off -- for the new opportunities with 5G mobile edge compute, private 5G networks, the 5G Business Internet, which is using fixed wireless access. So we have a lot of new products coming out as we're building, and we have the same ambitions when it comes to financials, then we will be realistic what's happening in the market and how the team -- but I'm proud of the team of what they are transforming to and what we're aspiring for. And seeing the progress on mobile edge compute and Business Internet, that's, of course, new opportunities that we have not seen coming into the P&L yet, but we're building it together with the transformation we're doing.

Matt Ellis - *Verizon Communications Inc. - Executive VP & CFO*

Yes. So just a couple of other comments on the business margin there, Colby. So Hans mentioned the higher volumes. We mentioned it upfront that the wireless volumes that we saw the gross adds were not just higher than 2Q last year, also higher than 2Q '19. So certainly seeing volumes come back, especially in enterprise and small, medium business. So that's having some impact there and then obviously, the wireline pressure.

I would expect second half margins to be reasonably similar to what we saw in the first half of the year. The business transformation work the team is doing is having positive impacts with more to come as we go forward here. So I feel good about the direction the team is headed there in spite of the secular wireline pressures that we see.

And then in terms of your question on promotions, as Hans said, it's a promotion. That means it has both a start date and an end date, and today is the end date. So we've run promotions since the beginning of the wireless industry. They've evolved over time. They will continue to do so.

And the great position we're in is because of the strong operational results and financial results, it gives us the ability when the time is right in the marketplace to bring the right promotion out there. We felt this was the right promotion at this time with the economic reopening and wanting to get more customers with a 5G device in their hand as we're about to launch C-Band within the next 6 months, so we will continue to look at what is the right promotion for the right time. But the underlying operational performance of the business showing up in sequential wireless service revenue increase yet again gives us the position to have flexibility as we think about how we approach the market.

Brady Connor - *Verizon Communications Inc. - SVP of IR*

Great. Thanks, Colby. That's all the time we have today for questions. Thanks, everybody, and be safe.

Operator

Ladies and gentlemen, this does conclude the conference call for today. Thank you for your participation and for using Verizon Conference Services. You may now disconnect.