

VERIZON COMMUNICATIONS INC

Form 10-Q

May 09, 2005

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark one)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2005

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-8606

**Verizon Communications Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State of Incorporation)

**1095 Avenue of the Americas**  
**New York, New York**

(Address of principal executive offices)

**23-2259884**

(I.R.S. Employer Identification No.)

**10036**

(Zip Code)

Registrant's telephone number (212) 395-2121

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At March 31, 2005, 2,767,166,159 shares of the registrant's Common Stock were outstanding, after deducting 7,699,222 shares held in treasury.

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**Table of Contents****Part I Financial Information****Item 1. Financial Statements****Condensed Consolidated Statements of Income**

Verizon Communications Inc. and Subsidiaries

(Dollars in Millions, Except Per Share Amounts) (Unaudited)	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Operating Revenues</b>	\$ 18,179	\$ 17,056
<b>Operating Expenses</b>		
Cost of services and sales (exclusive of items shown below)	6,123	5,490
Selling, general and administrative expense	5,214	5,675
Depreciation and amortization expense	3,460	3,425
<b>Total Operating Expenses</b>	14,797	14,590
<b>Operating Income</b>	3,382	2,466
Equity in earnings of unconsolidated businesses	193	199
Income from other unconsolidated businesses	56	72
Other income and (expense), net	79	(34)
Interest expense	(561)	(638)
Minority interest	(613)	(477)
<b>Income Before Provision for Income Taxes and Discontinued Operations</b>	2,536	1,588
Provision for income taxes	(779)	(405)
<b>Income Before Discontinued Operations</b>	1,757	1,183
<b>Discontinued Operations</b>		
Income from operations		29
Provision for income taxes		(13)
<b>Income on discontinued operations, net of tax</b>		16
<b>Net Income</b>	\$ 1,757	\$ 1,199
<b>Basic Earnings Per Common Share<sup>(1)</sup></b>		
Income before discontinued operations	\$ .63	\$ .43
Income on discontinued operations, net of tax		.01
<b>Net Income</b>	\$ .63	\$ .43
Weighted-average shares outstanding (in millions)	2,769	2,770

**Diluted Earnings Per Common Share**

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Income before discontinued operations	\$ .63	\$ .42
Income on discontinued operations, net of tax		.01
<b>Net Income</b>	<b>\$ .63</b>	<b>\$ .43</b>
Weighted-average shares outstanding (in millions)	2,821	2,847
Dividends declared per common share	\$ .405	\$ .385

(1) Total per share amounts may not add due to rounding.

See Notes to Condensed Consolidated Financial Statements

**Table of Contents****Condensed Consolidated Balance Sheets**

Verizon Communications Inc. and Subsidiaries

(Dollars in Millions, Except Per Share Amounts) (Unaudited)	At March 31, 2005	At December 31, 2004
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 692	\$ 2,290
Short-term investments	2,019	2,257
Accounts receivable, net of allowances of \$1,568 and \$1,670	9,285	9,801
Inventories	1,460	1,535
Assets held for sale	964	950
Prepaid expenses and other	2,591	2,646
<b>Total current assets</b>	<b>17,011</b>	<b>19,479</b>
Plant, property and equipment	187,482	185,522
Less accumulated depreciation	113,111	111,398
	74,371	74,124
Investments in unconsolidated businesses	5,817	5,855
Wireless licenses	42,629	42,090
Goodwill	837	837
Other intangible assets, net	4,520	4,521
Other assets	19,697	19,052
<b>Total assets</b>	<b>\$ 164,882</b>	<b>\$ 165,958</b>
<b>Liabilities and Shareowners Investment</b>		
Current liabilities		
Debt maturing within one year	\$ 3,716	\$ 3,593
Accounts payable and accrued liabilities	13,202	13,177
Liabilities related to assets held for sale	400	525
Other	5,841	5,834
<b>Total current liabilities</b>	<b>23,159</b>	<b>23,129</b>
Long-term debt	35,471	35,674
Employee benefit obligations	17,687	17,941
Deferred income taxes	21,811	22,532
Other liabilities	4,020	4,069
Minority interest	24,754	25,053
Shareowners investment		
Series preferred stock (\$.10 par value; none issued)		
Common stock (\$.10 par value; 2,774,865,381 shares issued in both periods)	277	277
Contributed capital	25,387	25,404
Reinvested earnings	13,621	12,984
Accumulated other comprehensive loss	(1,222)	(1,053)
Common stock in treasury, at cost	(229)	(142)
Deferred compensation employee stock ownership plans and other	146	90

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Total shareowners' investment	37,980	37,560
Total liabilities and shareowners' investment	\$ 164,882	\$ 165,958

See Notes to Condensed Consolidated Financial Statements

**Table of Contents****Condensed Consolidated Statements of Cash Flows**

Verizon Communications Inc. and Subsidiaries

(Dollars in Millions) (Unaudited)	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Cash Flows from Operating Activities</b>		
Income before discontinued operations	\$ 1,757	\$ 1,183
Adjustments to reconcile income before discontinued operations to net cash provided by operating activities:		
Depreciation and amortization	3,460	3,425
Employee retirement benefits	435	1,054
Deferred income taxes	(281)	124
Provision for uncollectible accounts	316	390
Income from unconsolidated businesses	(249)	(271)
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses	(250)	(1,771)
Other, net	(1,252)	(92)
<b>Net cash provided by operating activities</b>	<b>3,936</b>	<b>4,042</b>
<b>Cash Flows from Investing Activities</b>		
Capital expenditures (including capitalized software)	(3,594)	(2,641)
Acquisitions, net of cash acquired, and investments	(1,178)	(34)
Proceeds from disposition of businesses	117	117
Net change in short-term investments	237	282
Other, net	223	188
<b>Net cash used in investing activities</b>	<b>(4,312)</b>	<b>(2,088)</b>
<b>Cash Flows from Financing Activities</b>		
Proceeds from long-term borrowings	8	500
Repayments of long-term borrowings and capital lease obligations	(384)	(2,049)
Increase in short-term obligations, excluding current maturities	334	572
Dividends paid	(1,066)	(1,065)
Proceeds from sale of common stock	25	80
Purchase of common stock for treasury	(118)	-
Other, net	(21)	(86)
<b>Net cash used in financing activities</b>	<b>(1,222)</b>	<b>(2,048)</b>
Decrease in cash and cash equivalents	(1,598)	(94)
Cash and cash equivalents, beginning of period	2,290	669
<b>Cash and cash equivalents, end of period</b>	<b>\$ 692</b>	<b>\$ 575</b>

See Notes to Condensed Consolidated Financial Statements





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**Notes to Condensed Consolidated Financial Statements**

Verizon Communications Inc. and Subsidiaries

(Unaudited)

**1. Basis of Presentation**

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The accompanying unaudited condensed consolidated financial statements have been prepared based upon Securities and Exchange Commission (SEC) rules that permit reduced disclosure for interim periods. These financial statements reflect all adjustments that are necessary for a fair presentation of results of operations and financial condition for the interim periods shown including normal recurring accruals and other items. The results for the interim periods are not necessarily indicative of results for the full year. For a more complete discussion of significant accounting policies and certain other information, you should refer to the financial statements included in the Verizon Communications Inc. (Verizon) Annual Report on Form 10-K for the year ended December 31, 2004.

We have reclassified prior year amounts to conform to the current year presentation.

**2. MCI Acquisition**

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On February 14, 2005, Verizon announced that it had agreed to acquire MCI, Inc. for a combination of Verizon common shares and cash (including MCI dividends). On May 2, 2005, Verizon announced that it agreed with MCI to further amend its agreement to acquire MCI for cash and stock of at least \$26.00 per share, consisting of cash of \$5.60, which is expected to be paid as a special dividend by MCI soon after the approval of the transaction by MCI shareholders, plus the greater of .5743 Verizon shares for each MCI common share or a sufficient number of Verizon shares to deliver to shareholders \$20.40 of value. Under this price protection feature, Verizon may elect to pay additional cash instead of issuing additional shares over the .5743 exchange ratio. This consideration is subject to adjustment at closing and may be decreased based on MCI's bankruptcy claims-related experience and international tax liabilities. The MCI board of directors has unanimously agreed to recommend approval of the amended agreement to its shareholders. In addition to MCI shareholder approval, the acquisition requires regulatory approvals, which the companies are targeting to obtain by year-end 2005.

Separately, on April 9, 2005, Verizon announced an agreement had been reached with eight entities affiliated with Carlos Slim Helu to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash. Under the agreement, Verizon will pay the Slim entities an adjustment at the end of one year in an amount per MCI share equal to 0.7241 times the amount by which the price of Verizon's common stock exceeds \$35.52 per share to a maximum of \$62.50 (measured over a 20-day period) plus an additional cash amount of 3% per annum from April 9, 2005 until the closing of the purchase of those shares. The purchase, which is subject to regulatory approvals, is expected to close in the second quarter of 2005.

**3. Accounting Change**

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Effective January 1, 2003, we adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, using the prospective method (as permitted under SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure ) to all new awards granted, modified or settled after January 1, 2003. The following table illustrates the effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested options in each period.

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(Dollars in Millions, Except Per Share Amounts)	Three Months Ended March 31,	
	2005	2004
<b>Net Income, As Reported</b>	\$ 1,757	\$ 1,199
Add: Stock option-related employee compensation expense included in reported net income, net of related tax effects	17	13
Deduct: Total stock option-related employee compensation expense determined under fair value based method for all awards, net of related tax effects	(17)	(31)
<b>Pro Forma Net Income</b>	\$ 1,757	\$ 1,181
<b>Earnings Per Share:</b>		
Basic as reported	\$ .63	\$ .43
Basic pro forma	.63	.43
Diluted as reported	\$ .63	\$ .43
Diluted pro forma	.63	.42

After-tax compensation expense for other stock-based compensation included in net income as reported for the three months ended March 31, 2005 and 2004 was \$121 million and \$51 million, respectively.

**4. Strategic Actions**

During the first quarter of 2004, we recorded pretax pension settlement losses of \$728 million (\$446 million after-tax) related to employees that received lump-sum distributions during the quarter in connection with the 2003 voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003. This charge was recorded in accordance with SFAS No. 88, Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, which requires that settlement losses be recorded once prescribed payment thresholds have been reached.

Also, during the first quarter of 2004 we recorded pretax charges of \$43 million (\$27 million after-tax) resulting from the early retirement of debt.

**5. Discontinued Operations**

During 2004, we announced our decision to sell Verizon Information Services Canada Inc. to an affiliate of Bain Capital, a global private investment firm, for \$1,540 million (Cdn. \$1,985 million). The sale closed during the fourth quarter of 2004 and resulted in a gain of \$1,017 million (\$516 million after-tax). In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we have classified the results of operations of Verizon Information Services Canada as discontinued operations in the unaudited condensed consolidated statements of income for the three months ended March 31, 2004.

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Summarized results of operations for Verizon Information Services Canada, follows:

(Dollars in Millions)	Three Months Ended March 31,	
	2005	2004
Income from operations of Verizon Information Services Canada before income taxes	\$	\$ 29
Income tax provision		(13)
Income on discontinued operations, net of tax	\$	\$ 16

Included in income from operations of Verizon Information Services Canada before income taxes in the preceding table are operating revenues of \$80 million for the three months ended March 31, 2004.

### 6. Assets Held for Sale

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During 2004, we announced an agreement with an affiliate of The Carlyle Group to sell our wireline-related businesses in Hawaii, including Verizon Hawaii Inc. which operates 707,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select

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Services Inc. in Hawaii, for \$1,650 million in cash, less debt. In connection with obtaining approval of the Hawaii Public Utilities Commission, The Carlyle Group agreed to contribute additional equity to the Hawaii businesses. Consequently, Verizon agreed to reduce the selling price to \$1,600 million, less debt. The Federal Communications Commission, the U.S. Department of Justice and the Hawaii Public Utilities Commission have provided the necessary approvals. The transaction closed on May 2, 2005. As a result of this agreement, we have separately classified the assets held for sale and related liabilities in the March 31, 2005 and December 31, 2004 unaudited condensed consolidated balance sheets. Additional detail related to the assets held for sale, and related liabilities, follows:

(Dollars in Millions)	At March 31, 2005	At December 31, 2004
Current assets	\$ 112	\$ 109
Plant, property and equipment, net	834	820
Other non-current assets	18	21
<b>Total assets</b>	<b>\$ 964</b>	<b>\$ 950</b>
Debt maturing within one year	\$ 150	\$ 125
Other current liabilities	49	48
Long-term debt	151	302
Other non-current liabilities	50	50
<b>Total liabilities</b>	<b>\$ 400</b>	<b>\$ 525</b>

**7. Goodwill and Other Intangible Assets***Goodwill*

Changes in the carrying amount of goodwill for the three months ended March 31, 2005 are as follows:

(Dollars in Millions)	Domestic Telecom	Information Services	International	Total
<b>Balance at December 31, 2004</b>	\$ 315	\$ 77	\$ 445	\$ 837
Goodwill reclassifications and other				
<b>Balance at March 31, 2005</b>	<b>\$ 315</b>	<b>\$ 77</b>	<b>\$ 445</b>	<b>\$ 837</b>

*Other Intangible Assets*

The major components and average useful lives of our other intangible assets follows:

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(Dollars in Millions)	At March 31, 2005		At December 31, 2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Amortized intangible assets:</b>				
Customer lists (4 to 7 years)	\$ 3,450	\$ 2,946	\$ 3,444	\$ 2,832
Non-network internal-use software (3 to 7 years)	7,016	3,041	6,866	2,997
Other (1 to 25 years)	63	22	62	22
<b>Total</b>	<b>\$ 10,529</b>	<b>\$ 6,009</b>	<b>\$ 10,372</b>	<b>\$ 5,851</b>
<b>Unamortized intangible assets:</b>				
Wireless licenses	\$ 42,629		\$ 42,090	

Intangible asset amortization expense was \$371 million and \$343 million for the three months ended March 31, 2005 and 2004, respectively. It is estimated to be \$1,123 million for the remainder of 2005, \$1,053 million in 2006, \$740 million in 2007, \$583 million in 2008 and \$469 million in 2009, primarily related to customer lists and non-network internal-use software.

## 8. Debt

### *Support Agreements and Guarantees*

All of Verizon Global Funding's debt has the benefit of Support Agreements between us and Verizon Global Funding, which give holders of Verizon Global Funding debt the right to proceed directly against us for payment of interest, premium (if any) and principal outstanding should Verizon Global Funding fail to pay. The holders of Verizon Global Funding debt do not have recourse to the stock or assets of most of our telephone operations;

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however, they do have recourse to dividends paid to us by any of our consolidated subsidiaries as well as assets not covered by the exclusion. Verizon Global Funding's long-term debt, including current portion, aggregated \$13,655 million at March 31, 2005. The carrying value of the available assets reflected in our unaudited condensed consolidated balance sheets was approximately \$60.7 billion at March 31, 2005.

Verizon and NYNEX Corporation are the joint and several co-obligors of the 20-Year 9.55% Debentures due 2010 previously issued by NYNEX on March 26, 1990. As of March 31, 2005, \$145 million principal amount of this obligation remained outstanding. In addition, Verizon Global Funding has guaranteed the debt obligations of GTE Corporation (but not the debt of its subsidiary or affiliate companies) that were issued and outstanding prior to July 1, 2003. As of March 31, 2005, \$3,475 million principal amount of these obligations remained outstanding. NYNEX and GTE no longer issue public debt or file SEC reports. See Note 13 for information on guarantees of operating subsidiary debt listed on the New York Stock Exchange.

*Zero-Coupon Convertible Notes*

Previously, Verizon Global Funding issued approximately \$5.4 billion in principal amount at maturity of zero-coupon convertible notes due 2021 which are redeemable at the option of the holders on May 15<sup>th</sup> in each of the years 2004, 2006, 2011 and 2016. In addition, the zero-coupon convertible notes are callable by Verizon Global Funding on or after May 15, 2006. On May 15, 2004, \$3,292 million of principal amount of the notes (\$1,984 million after unamortized discount) were redeemed by Verizon Global Funding. As of March 31, 2005, the remaining zero-coupon convertible notes were classified as long-term since they are not redeemable at the option of the holders again until May 15, 2006.

*Debt Covenants*

We and our consolidated subsidiaries are in compliance with all of our debt covenants.

**9. Comprehensive Income**

Comprehensive income consists of net income and other gains and losses affecting shareowners' investment that, under GAAP, are excluded from net income.

Changes in the components of other comprehensive income (loss) are as follows:

(Dollars in Millions)	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Net Income</b>	\$ 1,757	\$ 1,199
<b>Other Comprehensive Income (Loss), Net of Taxes</b>		
Foreign currency translation adjustments	(171)	(251)



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Unrealized derivative gains (losses) on cash flow hedges	2	(21)
Unrealized gains on marketable securities	1	12
Minimum pension liability adjustment	(1)	(18)
	<u>(169)</u>	<u>(278)</u>
<b>Total Comprehensive Income</b>	<b>\$ 1,588</b>	<b>\$ 921</b>

The unrealized foreign currency translation loss in the first quarter of 2005 is primarily driven by a decline in the functional currency on our investment in Vodafone Omnitel N.V. (Vodafone Omnitel), partially offset by the appreciation of the functional currency on our investment in Verizon Dominicana, C. por A. (Verizon Dominicana). The unrealized foreign currency translation loss in the first quarter of 2004 is primarily driven by the impact of the euro on our investment in Vodafone Omnitel and by unrealized foreign currency translation losses at Verizon Dominicana and Compañía Anónima Nacional Teléfonos de Venezuela.

The components of Accumulated Other Comprehensive Loss are as follows:

(Dollars in Millions)	At March 31, 2005	At December 31, 2004
Foreign currency translation adjustments	\$ (283)	\$ (112)
Unrealized derivative losses on cash flow hedges	(35)	(37)
Unrealized gains on marketable securities	32	31
Minimum pension liability adjustment	(936)	(935)
	<u>\$ (1,222)</u>	<u>\$ (1,053)</u>
Accumulated other comprehensive loss	\$ (1,222)	\$ (1,053)

**Table of Contents****10. Earnings Per Share**

The following table is a reconciliation of the share amounts used in computing earnings per share.

(Dollars and Shares in Millions, Except Per Share Amounts)	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Net Income Used For Basic Earnings Per Common Share</b>		
Income before discontinued operations	\$ 1,757	\$ 1,183
Income on discontinued operations, net of tax		16
Net income	\$ 1,757	\$ 1,199
<b>Net Income Used For Diluted Earnings Per Common Share</b>		
Income before discontinued operations	\$ 1,757	\$ 1,183
After-tax minority interest expense related to exchangeable equity interest	7	6
After-tax interest expense related to zero-coupon convertible notes	7	16
Income before discontinued operations after assumed conversion of dilutive securities	1,771	1,205
Income on discontinued operations, net of tax		16
Net income after assumed conversion of dilutive securities	\$ 1,771	\$ 1,221
<b>Basic Earnings Per Common Share<sup>(1)</sup></b>		
Weighted-average shares outstanding basic	2,769	2,770
Income before discontinued operations	\$ .63	\$ .43
Income on discontinued operations, net of tax		.01
Net income	\$ .63	\$ .43
<b>Diluted Earnings Per Common Share</b>		
Weighted-average shares outstanding basic	2,769	2,770
Effect of dilutive securities:		
Stock options	6	5
Exchangeable equity interest	29	29
Zero-coupon convertible notes	17	43
Weighted-average shares diluted	2,821	2,847
Income before discontinued operations	\$ .63	\$ .42
Income on discontinued operations, net of tax		.01
Net income	\$ .63	\$ .43

(1) Total per share amounts may not add due to rounding.

Stock options for 249 million shares for the three months ended March 31, 2005 and 243 million shares for the three months ended March 31, 2004 were not included in the computation of diluted earnings per share because the exercise price of the stock options was greater than the average market price of the common stock.

## 11. Segment Information

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We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments include: Domestic Telecom principally representing our telephone operations that provide local telephone services in 28 states and Washington, D.C., including voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones as well as long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services; Domestic Wireless domestic wireless products and services, including wireless voice and data services and equipment sales across the United States; Information Services representing our directory publishing businesses and electronic commerce services; and International which includes wireline and wireless communications operations and investments primarily in the Americas and Europe.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded from the business

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segment results, they are included in reported consolidated earnings. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers' assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

The following table provides operating financial information for our four reportable segments and a reconciliation of segment results to consolidated results:

(Dollars in Millions)	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>External Operating Revenues</b>		
Domestic Telecom	\$ 9,278	\$ 9,423
Domestic Wireless	7,399	6,149
Information Services	897	919
International	510	462
Total segments	18,084	16,953
Reconciling items	95	103
Total consolidated reported	\$ 18,179	\$ 17,056
<b>Intersegment Revenues</b>		
Domestic Telecom	\$ 222	\$ 191
Domestic Wireless	19	13
Information Services		
International	7	6
Total segments	248	210
Reconciling items	(248)	(210)
Total consolidated reported	\$	\$
<b>Total Operating Revenues</b>		
Domestic Telecom	\$ 9,500	\$ 9,614
Domestic Wireless	7,418	6,162
Information Services	897	919
International	517	468
Total segments	18,332	17,163
Reconciling items	(153)	(107)
Total consolidated reported	\$ 18,179	\$ 17,056
<b>Operating Income</b>		
Domestic Telecom	\$ 1,300	\$ 1,490
Domestic Wireless	1,540	1,202
Information Services	434	443
International	99	116
Total segments	3,373	3,251

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Reconciling items		9	(785)
Total consolidated reported		\$ 3,382	\$ 2,466
<b>Segment Income</b>			
Domestic Telecom		\$ 528	\$ 697
Domestic Wireless		433	318
Information Services		271	271
International		351	281
Total segment income		1,583	1,567
Reconciling items		174	(368)
Total consolidated net income reported		\$ 1,757	\$ 1,199

(Dollars in Millions)

At March 31, 2005

At December 31, 2004

**Assets**

Domestic Telecom	\$ 77,014	\$ 78,824
Domestic Wireless	69,476	68,027
Information Services	1,659	1,680
International	13,625	14,885
Total segments	161,774	163,416
Reconciling items	3,108	2,542
Total consolidated	\$ 164,882	\$ 165,958

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Major reconciling items between the segments and the consolidated results are as follows:

(Dollars in Millions)	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Total Operating Revenues</b>		
Corporate, eliminations and other	\$ (153)	\$ (107)
	<u>\$ (153)</u>	<u>\$ (107)</u>
<b>Operating Income</b>		
Severance, pension and benefit charges (see Note 4)	\$	\$ (728)
Corporate and other	9	(57)
	<u>\$ 9</u>	<u>\$ (785)</u>
<b>Net Income</b>		
Severance, pension and benefit charges (see Note 4)	\$	\$ (446)
Sales of investments, net		43
Other special items (see Note 4)		(27)
Income on discontinued operations (see Note 5)		16
Corporate and other	174	46
	<u>\$ 174</u>	<u>\$ (368)</u>

During the first quarter of 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of \$43 million (\$43 million after-tax) included in Income From Other Unconsolidated Businesses in the unaudited condensed consolidated statements of income.

Financial information for Information Services excludes the effects of Verizon Information Services Canada (see Note 5).

Corporate, eliminations and other includes unallocated corporate expenses, intersegment eliminations recorded in consolidation, the results of other businesses such as lease financing, and asset impairments and expenses that are not allocated in assessing segment performance due to their non-recurring nature.

We generally account for intersegment sales of products and services and asset transfers at current market prices. We are not dependent on any single customer.

**12. Employee Benefits**

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We maintain noncontributory defined benefit pension plans for substantially all employees. In addition, we maintain postretirement health care and life insurance plans for our retirees and their dependents, which are both contributory and non-contributory and include a limit on the company's share of cost for certain recent and future retirees.

### *Net Periodic Cost*

The following table summarizes the benefit costs related to our pension and postretirement health care and life insurance plans:

Three Months Ended March 31,	(Dollars in Millions)			
	Pension		Health Care and Life	
	2005	2004	2005	2004
Service cost	\$ 182	\$ 173	\$ 92	\$ 70
Interest cost	519	542	379	378
Expected return on plan assets	(839)	(875)	(88)	(101)
Amortization of transition asset		(1)	1	1
Amortization of prior service cost	11	14	68	60
Actuarial loss, net	41	13	69	50
Net periodic benefit (income) cost	(86)	(134)	521	458
Termination benefits		2		
Settlement loss		728		
Total (income) cost	\$ (86)	\$ 596	\$ 521	\$ 458

**Table of Contents***Employer Contributions*

In 2005, based on the funded status of the plans at December 31, 2004, we anticipate qualified pension trust contributions of \$730 million, including voluntary contributions, \$140 million to our nonqualified pension plans and \$1,060 million to our other postretirement benefit plans. During the three months ended March 31, 2005, we contributed \$698 million to our qualified pension trusts, \$46 million to our nonqualified pension plans and \$296 million to our other postretirement benefit plans. Federal legislation on pension funding relief was enacted on April 10, 2004. The legislation provides temporary funding relief for the 2004 and 2005 plan years, principally replacing the 30-year treasury rate with a higher corporate bond rate for determining current liability. The anticipated required qualified pension trust contributions disclosed in Verizon's Annual Report on Form 10-K for the year ended December 31, 2004 continue to be accurate.

*Medicare Drug Act*

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Drug Act) was signed into law. The Medicare Drug Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. We sponsor several postretirement health care plans that provide prescription drug benefits that are deemed actuarially equivalent to the Medicare Part D. We elected to recognize the impact of the federal subsidy on our accumulated postretirement benefit obligation and net postretirement benefit costs in the fourth quarter of 2003. We anticipate the recognition of the Medicare Drug Act to decrease our accumulated postretirement benefit obligation by \$1,337 million. During the quarter ended March 31, we have reduced our net postretirement benefit cost as follows:

Three Months Ended March 31,	(dollars in millions)	
	2005	2004
Service cost	\$ 6	\$ 4
Interest cost	23	19
Actuarial gain	23	13
Net periodic benefit cost	\$ 52	\$ 36

*Severance Benefits*

During the three months ended March 31, 2005, we paid severance benefits of \$62 million. At March 31, 2005, we had a remaining severance liability of \$725 million, which includes future contractual payments to employees separated as of March 31, 2005.



**Table of Contents****13. Guarantees of Operating Subsidiary Debt**

Verizon has guaranteed the following two obligations of indirect wholly owned operating subsidiaries: \$480 million 7% debentures series B, due 2042 issued by Verizon New England Inc. and \$300 million 7% debentures series F issued by Verizon South Inc. due 2041. These guarantees are full and unconditional and would require Verizon to make scheduled payments immediately if either of the two subsidiaries failed to do so. Both of these securities were issued in denominations of \$25 and were sold primarily to retail investors and are listed on the New York Stock Exchange. SEC rules permit us to include condensed consolidating financial information for these two subsidiaries in our periodic SEC reports rather than filing separate subsidiary periodic SEC reports.

Below is the condensed consolidating financial information. Verizon New England and Verizon South are presented in separate columns. The column labeled Parent represents Verizon's investments in all of its subsidiaries under the equity method and the Other column represents all other subsidiaries of Verizon on a combined basis. The Adjustments column reflects intercompany eliminations.

**Condensed Consolidating Statements of Income****Three Months Ended March 31, 2005**

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Operating revenues	\$	\$ 973	\$ 229	\$ 17,083	\$ (106)	\$ 18,179
Operating expenses	23	863	168	13,849	(106)	14,797
<b>Operating income (loss)</b>	(23)	110	61	3,234		3,382
Equity in earnings of unconsolidated businesses	1,601	8		82	(1,498)	193
Income from other unconsolidated businesses				56		56
Other income and (expense), net	106	1	1	77	(106)	79
Interest expense	(5)	(42)	(16)	(501)	3	(561)
Minority interest				(613)		(613)
<b>Income before provision for income taxes</b>	1,679	77	46	2,335	(1,601)	2,536
Income tax benefit (provision)	78	(25)	(18)	(814)		(779)
<b>Net income</b>	\$ 1,757	\$ 52	\$ 28	\$ 1,521	\$ (1,601)	\$ 1,757

**Condensed Consolidating Statements of Income****Three Months Ended March 31, 2004**

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
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Operating revenues	\$	\$ 992	\$ 234	\$ 15,912	\$ (82)	\$ 17,056	
Operating expenses		109	986	192	13,385	(82)	14,590
<hr/>							
<b>Operating income</b>		(109)	6	42	2,527		2,466
Equity in earnings of unconsolidated businesses		1,213	19		169	(1,202)	199
Income from other unconsolidated businesses					72		72
Other income and (expense), net		14	7	1	(43)	(13)	(34)
Interest expense		(5)	(41)	(16)	(578)	2	(638)
Minority interest					(477)		(477)
<hr/>							
<b>Income (loss) before provision for income taxes and discontinued operations</b>		1,113	(9)	27	1,670	(1,213)	1,588
Income tax benefit (provision)		86	17	(10)	(498)		(405)
<hr/>							
<b>Income before discontinued operations</b>		1,199	8	17	1,172	(1,213)	1,183
Income on discontinued operations, net of tax					16		16
<hr/>							
<b>Net income</b>	\$	\$ 1,199	\$ 8	\$ 17	\$ 1,188	\$ (1,213)	\$ 1,199
<hr/>							

**Table of Contents****Condensed Consolidating Balance Sheets****At March 31, 2005**

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	\$	\$	\$	\$ 692	\$	\$ 692
Short-term investments		155	29	1,835		2,019
Accounts receivable, net	4	848	134	9,312	(1,013)	9,285
Other current assets	7,411	138	159	4,881	(7,574)	5,015
<b>Total current assets</b>	<b>7,415</b>	<b>1,141</b>	<b>322</b>	<b>16,720</b>	<b>(8,587)</b>	<b>17,011</b>
Plant, property and equipment, net	1	6,342	1,190	66,838		74,371
Investments in unconsolidated businesses	32,640	117		9,566	(36,506)	5,817
Other assets	454	468	377	66,614	(230)	67,683
<b>Total assets</b>	<b>\$ 40,510</b>	<b>\$ 8,068</b>	<b>\$ 1,889</b>	<b>\$ 159,738</b>	<b>\$ (45,323)</b>	<b>\$ 164,882</b>
Debt maturing within one year	\$ 32	\$ 170	\$	\$ 11,123	\$ (7,609)	\$ 3,716
Other current liabilities	2,245	1,180	179	16,817	(978)	19,443
<b>Total current liabilities</b>	<b>2,277</b>	<b>1,350</b>	<b>179</b>	<b>27,940</b>	<b>(8,587)</b>	<b>23,159</b>
Long-term debt	114	2,952	901	31,734	(230)	35,471
Employee benefit obligations	138	1,856	238	15,455		17,687
Deferred income taxes		536	241	21,034		21,811
Other liabilities	1	198	32	3,789		4,020
Minority interest				24,754		24,754
Total shareowners investment	37,980	1,176	298	35,032	(36,506)	37,980
<b>Total liabilities and shareowners investment</b>	<b>\$ 40,510</b>	<b>\$ 8,068</b>	<b>\$ 1,889</b>	<b>\$ 159,738</b>	<b>\$ (45,323)</b>	<b>\$ 164,882</b>

**Condensed Consolidating Balance Sheets****At December 31, 2004**

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Cash	\$	\$	\$	\$ 2,290	\$	\$ 2,290
Short-term investments		187	33	2,037		2,257
Accounts receivable, net	6	913	151	9,751	(1,020)	9,801
Other current assets	7,632	151	123	4,985	(7,760)	5,131
<b>Total current assets</b>	<b>7,638</b>	<b>1,251</b>	<b>307</b>	<b>19,063</b>	<b>(8,780)</b>	<b>19,479</b>
Plant, property and equipment, net	1	6,444	1,204	66,475		74,124
Investments in unconsolidated businesses	32,191	116		9,639	(36,091)	5,855
Other assets	408	488	374	65,460	(230)	66,500

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<b>Total assets</b>	\$ 40,238	\$ 8,299	\$ 1,885	\$ 160,637	\$ (45,101)	\$ 165,958
Debt maturing within one year	\$ 31	\$ 168	\$	\$ 11,222	\$ (7,828)	\$ 3,593
Other current liabilities	2,372	1,217	181	16,718	(952)	19,536
<b>Total current liabilities</b>	<b>2,403</b>	<b>1,385</b>	<b>181</b>	<b>27,940</b>	<b>(8,780)</b>	<b>23,129</b>
Long-term debt	113	2,966	901	31,924	(230)	35,674
Employee benefit obligations	160	1,940	235	15,606		17,941
Deferred income taxes		571	249	21,712		22,532
Other liabilities	2	253	34	3,780		4,069
Minority interest				25,053		25,053
Total shareowners investment	37,560	1,184	285	34,622	(36,091)	37,560
<b>Total liabilities and shareowners investment</b>	<b>\$ 40,238</b>	<b>\$ 8,299</b>	<b>\$ 1,885</b>	<b>\$ 160,637</b>	<b>\$ (45,101)</b>	<b>\$ 165,958</b>

**Table of Contents****Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2005**

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	\$ 2,171	\$ 180	\$ 85	\$ 3,717	\$ (2,217)	\$ 3,936
Net cash from investing activities		(123)	(70)	(4,159)	40	(4,312)
Net cash from financing activities	(2,171)	(57)	(15)	(1,156)	2,177	(1,222)
Net decrease in cash	\$	\$	\$	\$ (1,598)	\$	\$ (1,598)

**Condensed Consolidating Statements of Cash Flows****Three Months Ended March 31, 2004**

(Dollars in Millions)	Parent	Verizon New England	Verizon South	Other	Adjustments	Total
Net cash from operating activities	\$ 1,256	\$ 248	\$ 9	\$ 4,029	\$ (1,500)	\$ 4,042
Net cash from investing activities		(108)	10	(1,961)	(29)	(2,088)
Net cash from financing activities	(1,256)	(140)	(19)	(2,162)	1,529	(2,048)
Net decrease in cash	\$	\$	\$	\$ (94)	\$	\$ (94)

**14. Recent Accounting Pronouncement**

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 47, Accounting for Conditional Asset Retirement Obligations – an interpretation of FASB Statement No. 143. FIN No. 47 clarifies SFAS No. 143, Accounting for Asset Retirement Obligations, such that conditional asset retirement obligations require recognition at fair value if they can be reasonably estimated. These rules are effective December 31, 2005; we are currently evaluating the impact, if any, on our results of operations and financial position.

**15. Commitments and Contingencies**

Several state and federal regulatory proceedings may require our telephone operations to pay penalties or to refund to customers a portion of the revenues collected in the current and prior periods. There are also various legal actions pending to which we are a party and claims which, if asserted, may lead to other legal actions. We have established reserves for specific liabilities in connection with regulatory and legal actions, including environmental matters, that we currently deem to be probable and estimable. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods, including the Hicksville matters described below, will have a material effect on our financial

condition, but it could have a material effect on our results of operations.

During 2003, under a government-approved plan, remediation of the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of \$240 million was recorded in 2003. We expect overall remediation efforts, including soil and ground water remediation and property costs, to take place over the next several years, and our cost estimates may be revised as remediation continues.

There are also litigation matters associated with the Hicksville site primarily involving personal injury claims in connection with alleged emissions arising from operations in the 1950s and 1960s at the Hicksville site. These matters are in various stages.

In connection with the execution of agreements for the sales of businesses and investments, Verizon ordinarily provides representations and warranties to the purchasers pertaining to a variety of nonfinancial matters, such as ownership of the securities being sold, as well as financial losses.

Under the terms of an investment agreement, Vodafone Group Plc (Vodafone) may require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to \$12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to \$10 billion during a 61-day period

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opening on June 10 and closing on August 9 in 2004, and did not exercise that right. As a result, Vodafone still has the right to require the purchase of up to \$20 billion worth of its interest, not to exceed \$10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2005 through 2007. Vodafone also may require that Verizon Wireless pay for up to \$7.5 billion of the required repurchase through the assumption or incurrence of debt.

**16. Subsequent Event**

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On April 19, 2005, the board of directors of Vodafone Omnitel decided to submit to shareowners for approval at their May 2005 meeting a proposal to buy back issued and outstanding shares at a value of approximately 7.9 billion euros (\$10.3 billion). If the proposal is approved by the shareowners of Vodafone Omnitel, Verizon and Vodafone will participate on a pro rata basis with Verizon's ownership interest in Vodafone Omnitel remaining at 23.1% after the buy back. If approved, the transaction will occur in two tranches, the first in June 2005 and the second in October 2005.

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**Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition**

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**Overview**

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Verizon's domestic wireline telecommunications business provides local telephone services, including broadband, in 28 states and Washington, D.C. and nationwide long-distance and other communications products and services. The domestic wireline consumer business generally provides local, broadband and long distance services to customers. Our domestic wireline business also provides a variety of services to other telecommunications carriers as well as large and small businesses. Verizon's domestic wireless business provides wireless voice and data products and services across the United States using one of the most extensive wireless networks. Information Services operates directory publishing businesses and provides electronic commerce services. Verizon's international presence includes wireline and wireless communications operations and investments, primarily in the Americas and Europe. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of 212,000 employees.

The sections that follow provide information about the important aspects of our operations and investments, both at the consolidated and segment levels, and include discussions of our results of operations, financial position and sources and uses of cash. In addition, we have highlighted key trends and uncertainties to the extent practicable. The content and organization of the financial and non-financial data presented in these sections are consistent with information used by our chief operating decision makers for, among other purposes, evaluating performance and allocating resources. We also monitor several key economic indicators as well as the state of the economy in general, primarily in the United States where the majority of our operations are located, in evaluating our operating results and analyzing and understanding business trends. While most key economic indicators, including gross domestic product, impact our operations to some degree, we have noted higher correlations to housing starts, non-farm employment, personal consumption expenditures and capital spending, as well as more general economic indicators such as inflation and unemployment rates.

Our results of operations, financial position and sources and uses of cash in the current and future periods reflect Verizon management's focus on the following four key areas:

**Revenue Growth** Our emphasis is on revenue transformation, devoting more resources from traditional services, where we have been experiencing access line losses, to the higher growth markets such as wireless, wireline broadband connections, including digital subscriber lines (DSL) and fiber optics to the home (Verizon's FiOS data product), long distance and other data services as well as expanded services to enterprise markets. In the first quarter of 2005, revenues from these growth areas increased by 18% compared to the similar period in 2004 and represent 56% of our total revenues, up from 50% of total revenues in the first quarter of 2004. Verizon reported consolidated revenue growth of 6.6% in the first quarter of 2005 compared to the similar period in 2004, led by 20.4% higher revenue at Domestic Wireless and 11.6% total data revenue growth at Domestic Telecom. In addition, the total revenue decline at Domestic Telecom of 1.2% was the lowest rate of revenue decline in nearly four years. Verizon added 1,636,000 wireless customers, 385,000 broadband connections, 376,000 long distance lines and more than 800 Enterprise Advance sales in the first quarter of 2005.

**Operational Efficiency** While focusing resources on growth markets, we are continually challenging our management team to lower expenses, particularly through technology-assisted productivity improvements including self-service initiatives. The effect of these and other efforts, such as the 2003 labor agreements and voluntary separation plans and real estate consolidations and call center routing improvements, has been to significantly change the company's cost structure. Real estate consolidations include our recent announcement concerning the establishment of a new center in New Jersey for the leadership teams of Domestic Telecom, Domestic Wireless and International.

**Capital Allocation** Verizon's capital spending continues to be directed toward growth markets. High-speed wireless data (EV-DO) services, replacement of copper access lines with fiber optics to the home, as well as voice over the Internet (VoIP) and expanded services



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to enterprise markets are examples of areas of capital spending in support of these growth markets. In the first quarter of 2005, approximately 70% of capital spending was focused toward these growth areas, compared to 57% in the first quarter of 2004. In 2005, Verizon management expects to spend approximately 10% more than 2004 capital expenditures of \$13,259 million in support of growth initiatives. In addition to capital expenditures, Domestic Wireless continues to acquire wireless spectrum in support of expanding data applications and customer base. This includes participation in the Federal Communications Commission (FCC) Auction 58 and the NextWave Telecom Inc. (NextWave) and Qwest Wireless, LLC acquisitions.

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**Cash Flow Generation** The financial statements reflect the emphasis of management on not only directing resources to growth markets, but also using cash provided by our operating and investing activities for the repayment of debt in addition to providing a stable dividend to our shareowners. At March 31, 2005, Verizon's total debt was \$39,187 million, a decrease of 11.8% from \$44,452 million at March 31, 2004. However, acquisitions of wireless spectrum, as well as the purchase of MCI, Inc. shares from entities affiliated with Carlos Slim Helu (see **Other Factors That May Affect Future Results - Recent Developments**), will likely increase debt balances in the second quarter of 2005.

Supporting these key focus areas are continuing initiatives to more effectively package and add more value to our products and services. In 2004, Verizon announced a deployment expansion of FiOS in several states in our service territory. We have equipped more than 100 wire centers or central offices in 14 states, and have established a goal of passing three million homes by the end of 2005. Verizon plans to begin offering video on the FiOS network later this year which will include cable and broadcast channels, hundreds of other digital video channels, high-definition programming, video-on-demand content, music channels and an interactive programming guide. In 2004, we introduced VoiceWing, Verizon's nationwide VoIP service that allows wireline broadband customers to make telephone calls and utilize advanced service features through an Internet connection rather than the traditional telephone network. Innovative product bundles include local wireline, long distance, wireless and DSL services for consumer and general business retail customers. In our enterprise markets, we are expanding our presence having completed the build-out of our nationwide network and by expanding our portfolio of advanced data services. These efforts will also help counter the effects of competition and technology substitution that have resulted in access line losses that have contributed to declining Domestic Telecom revenues over the past several years.

At Domestic Wireless, we will continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business while at the same time provide new and innovative products and services for our customers. We are continuing to expand the areas where we are offering Broadband Access, our EV-DO service which provides typical data downloads of 300-500 kilobits per second. At year-end 2004, Domestic Wireless's EV-DO network reached 75 million people. Our goal is to reach 150 million people by year-end 2005. During the first quarter of 2005, we launched V CAST, our consumer broadband wireless service offering, which provides customers with unlimited access to a variety of video and gaming content on EV-DO handsets.

**Consolidated Results of Operations**

In this section, we discuss our overall results of operations and highlight special and non-recurring items. In the following section, we review the performance of our four reportable segments. We exclude the effects of the special and non-recurring items from the segments' results of operations since management does not consider them in assessing segment performance, due primarily to their non-recurring and/or non-operational nature. We believe that this presentation will assist readers in better understanding our results of operations and trends from period to period. This section on consolidated results of operations carries forward the segment results, which exclude the special and non-recurring items, and highlights and describes those items separately to ensure consistency of presentation in this section and the **Segment Results of Operations** section.

**Consolidated Revenues**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Domestic Telecom	\$ 9,500	\$ 9,614	(1.2)%
Domestic Wireless	7,418	6,162	20.4
Information Services	897	919	(2.4)
International	517	468	10.5
Corporate & Other	(153)	(107)	43.0
Consolidated Revenues	\$ 18,179	\$ 17,056	6.6

Consolidated revenues in the first quarter of 2005 were higher by \$1,123 million, or 6.6% compared to the similar period in 2004. This increase was primarily the result of significantly higher revenues at Domestic Wireless, partially offset by lower revenues at Domestic Telecom.

Domestic Wireless revenues increased by \$1,256 million, or 20.4% in the first quarter of 2005 compared to the similar period in 2004. This increase was primarily due to a 16.8% increase in customers as of March 31, 2005 compared to March 31, 2004 as well as an increase in average service revenue per customer (ARPU). ARPU increased by 2.1% to \$49.03 in the first quarter of 2005 compared to the similar period in 2004, primarily due to a

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higher proportion of customers on price plan offerings with higher access charges as well as an increase in data revenue per subscriber, partially offset by recent pricing changes to our America's Choice and family share plans. Increases in handsets sold and increased equipment upgrades also drove increases in equipment and other revenue in the first quarter of 2005 compared to the similar period in 2004.

Revenues at Domestic Telecom declined during the first quarter of 2005 by \$114 million, or 1.2% compared to the similar period in 2004 primarily due to lower revenues from local services, partially offset by higher long distance revenues. The decline in local service revenues of \$200 million, or 4.3% in the first quarter of 2005 compared to the similar period in 2004 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a 5.1% decline in switched access lines in service from March 31, 2004, driven by the effects of competition and technology substitution. Long distance service revenues increased \$83 million, or 8.3% in the first quarter of 2005 compared to the similar period in 2004 principally as a result of customer growth from our interLATA long distance services. As of March 31, 2005, we added approximately 1.9 million long distance lines or an 11.6% increase from March 31, 2004, for a total of 18.0 million long distance lines nationwide.

**Consolidated Operating Expenses**

(Dollars in Millions)	<b>Three Months Ended March 31,</b>		<b>% Change</b>
	<b>2005</b>	<b>2004</b>	
Cost of services and sales	\$ 6,123	\$ 5,490	11.5%
Selling, general and administrative expense	5,214	5,675	(8.1)
Depreciation and amortization expense	3,460	3,425	1.0
<b>Consolidated Operating Expenses</b>	<b>\$ 14,797</b>	<b>\$ 14,590</b>	<b>1.4</b>

**Cost of Services and Sales**

Consolidated cost of services and sales in first quarter 2005 increased \$633 million, or 11.5% compared to the similar period in 2004. This increase was driven by higher wireless network costs, increases in pension and other postretirement benefit costs and higher costs associated with our wireline growth businesses, including long distance and DSL.

The higher wireless network costs was caused by increased minutes of use (MOUs) on the wireless network in the first quarter of 2005 compared to the similar period in 2004, partially offset by lower roaming, local interconnection and long distance rates. Cost of wireless equipment sales increased in the first quarter of 2005 compared to the similar period in 2004 primarily as a result of an increase in handsets sold, due to an increase in gross activations and equipment upgrades in the first quarter of 2005 compared to the similar period in 2004.

Costs in this period were impacted by increased pension and other postretirement benefit costs. As of December 31, 2004, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets. The expected rate of return on pension plan assets has been maintained at 8.50%. However, the discount rate assumption has been lowered from 6.25% in 2004 to 5.75% in 2005, consistent with interest rate levels at the end of 2004. Further, there was an increase in the retiree health care cost trend rates. The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the past few years, resulted in pension and other postretirement benefit expense of \$349 million (primarily in cost of services and sales) in the first quarter of 2005 compared to \$274 million in the first quarter of 2004.

Also contributing to expense increases in cost of services and sales were higher costs associated with our growth businesses, including a 3,100, or a 2.2% increase in the number of Domestic Telecom employees as of March 31, 2005 compared to March 31, 2004.

### **Selling, General and Administrative Expense**

Consolidated selling, general and administrative expense in first quarter 2005 decreased by \$461 million, or 8.1% compared to the similar period in 2004. In the first quarter of 2004, we recorded pretax pension settlement losses of \$728 million related to employees that received lump-sum distributions during the quarter in connection with the 2003 voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003 and lower non-income taxes in the first quarter of 2005 compared to the similar period in 2004 principally related to gross receipts and property. These decreases in selling, general and administrative expense were partially offset by increases in salary and benefits expense in the first quarter of 2005, due to both higher per

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employee salary and benefits costs and an increase in our number of employees, higher sales commissions and higher advertising and promotion expenses, compared to the similar period in 2004. The first quarter of 2004 also included the impact of a gain on the sale of a small business unit.

**Depreciation and Amortization Expense**

Consolidated depreciation and amortization expense in the first quarter of 2005 was higher by \$35 million, or 1.0% compared to the similar period in 2004 primarily due to increased depreciation expense related to the increase in depreciable assets and capitalized non-network software, partially offset by lower Domestic Telecom depreciation rates.

**Other Consolidated Results****Equity in Earnings of Unconsolidated Businesses**

Equity in earnings of unconsolidated businesses decreased by \$6 million, or 3.0% in the first quarter of 2005 compared to the similar period in 2004. The decrease was primarily driven by reduced equity income in the current quarter resulting from the sale of our 20.5% interest in TELUS Corporation (TELUS) in the fourth quarter of 2004, partially offset by continued operational growth of Verizon's equity investment in Vodafone Omnitel N.V. (Vodafone Omnitel).

**Income From Other Unconsolidated Businesses**

Income from other unconsolidated businesses decreased by \$16 million, or 22.2% in the first quarter of 2005 compared to the similar period in 2004. The decrease was primarily driven by a pretax gain of \$43 million recorded in connection with the sale of an investment in Iowa Telecom preferred stock, and Taiwan Cellular Corporation share sales in the first quarter of 2004, partially offset by a gain on the sale of a small international wireless investment in the current period.

**Other Income and (Expense), Net**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Interest income	\$ 38	\$ 52	(26.9)%
Foreign exchange losses, net		(24)	(100.0)
Other, net	41	(62)	nm
Total	\$79	\$ (34)	nm

nm Not meaningful

The change in other income and expense, net for the first quarter of 2005 compared to the similar period in 2004 was primarily due to other, net income in the current period compared to other, net expenses in the prior year period and lower foreign exchange losses, partially offset by a decrease in interest income. Other, net income in the first quarter of 2005 includes leased asset gains. Other, net expenses in the first quarter of 2004 were driven by costs of \$43 million recorded in connection with the early retirement of debt.

### Interest Expense

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Interest expense	\$ 561	\$ 638	(12.1)%
Capitalized interest costs	60	35	71.4
<b>Total interest costs on debt balances</b>	<b>\$ 621</b>	<b>\$ 673</b>	<b>(7.7)</b>
Average debt outstanding	\$ 39,275	\$ 45,442	(13.6)
Effective interest rate	6.3%	5.9%	

The decrease in interest costs for the first quarter of 2005 compared to the similar period in 2004 was due to lower average debt levels of \$6,167 million, partially offset by higher average interest rates.

**Table of Contents****Minority Interest**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Minority Interest	\$ 613	\$ 477	28.5%

The increase in minority interest expense for the first quarter of 2005 compared to the similar period in 2004 is primarily due to the higher earnings at Domestic Wireless, which has a significant minority interest attributable to Vodafone Group PLC (Vodafone), partially offset by lower earnings at Telecomunicaciones de Puerto Rico, Inc. (TELPRI).

**Provision for Income Taxes**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Provision for Income Taxes	\$ 779	\$ 405	92.3%
Effective income tax rate	30.7%	25.5%	

The effective income tax rate is the provision for income taxes as a percentage of income from continuing operations before the provision for income taxes. Our effective income tax rate in the first quarter of 2005 was impacted by higher state income tax rates, more than offset by benefits related to the settlement of Internal Revenue Service (IRS) audits. Our effective income tax rate for the first quarter of 2004 was favorably impacted by tax benefits resulting from an IRS audit settlement and a benefit related to a deferred tax balance adjustment. In addition, we recorded a gain and expense credits during the prior year quarter that were not taxable.

**Discontinued Operations**

Discontinued operations represent the results of operations of Verizon Information Services Canada, Inc. prior to its sale in the fourth quarter of 2004. In accordance with Statement of Financial Accounting Standards (SFAS) No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets, we classified the results of operations of Verizon Information Services Canada as discontinued operations.

**Segment Results of Operations**

We have four reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments are Domestic Telecom, Domestic Wireless, Information Services and International. You can find additional information about our segments in Note 11 to the unaudited condensed consolidated financial statements.

We measure and evaluate our reportable segments based on segment income. This segment income excludes unallocated corporate expenses and other adjustments arising during each period. The other adjustments include transactions that the chief operating decision makers exclude in assessing business unit performance due primarily to their non-recurring and/or non-operational nature. Although such transactions are excluded



from business segment results, they are included in reported consolidated earnings. We previously highlighted the more significant of these transactions in the Consolidated Results of Operations section. Gains and losses that are not individually significant are included in all segment results, since these items are included in the chief operating decision makers assessment of unit performance. These gains and losses are primarily contained in Information Services and International since they actively manage investment portfolios.

#### **Domestic Telecom**

Domestic Telecom provides local telephone services, including voice and data transport, enhanced and custom calling features, network access, directory assistance, private lines and public telephones in 28 states and Washington, D.C. This segment also provides long distance services, customer premises equipment distribution, data solutions and systems integration, billing and collections, Internet access services and inventory management services.

**Table of Contents****Operating Revenues**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Local services	\$ 4,481	\$ 4,681	(4.3)%
Network access services	3,107	3,099	.3
Long distance services	1,081	998	8.3
Other services	831	836	(.6)
	<u>\$ 9,500</u>	<u>\$ 9,614</u>	(1.2)

*Local Services*

Local service revenues are earned by our telephone operations from the provision of local exchange, local private line, wire maintenance, voice messaging and value-added services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting and Return Call. The provision of local exchange services not only includes retail revenues but also includes local wholesale revenues from unbundled network elements (UNEs), interconnection revenues from competitive local exchange carriers (CLECs) and wireless carriers, and some data transport revenues.

The decline in local service revenues of \$200 million, or 4.3% in the first quarter of 2005 compared to the similar period in 2004 was mainly due to lower demand and usage of our basic local exchange and accompanying services, as reflected by a 5.1% decline in switched access lines in service from March 31, 2004. This revenue decline was mainly driven by the effects of competition and technology substitution. Technology substitution affected local service revenue growth in both years, as indicated by declining demand for residential access lines of 6.0% at March 31, 2005 compared to March 31, 2004, as more customers substituted wireless services for traditional landline services. At the same time, basic business access lines declined 3.6% at March 31, 2005 compared to March 31, 2004, primarily reflecting competition and a shift to high-speed, high-volume special access lines.

In the first quarter of 2005, the FCC adopted significant new unbundling rules which eliminated the requirement to unbundle mass market local switching on a nationwide basis. See *Other Factors That May Affect Future Results* *FCC Regulation and Interstate Rates* for additional information on FCC rulemakings concerning UNEs. Due to a recent decision by two major competitors to deemphasize their local market initiatives, wholesale voice connections (UNE platform and resale lines) declined 200,000 in the quarter, to 6.4 million as of March 31, 2005, which reflected a 2.3% increase compared to March 31, 2004.

We continue to seek opportunities to retain and win-back customers. Our Freedom service plans offer local services with various combinations of long distance, wireless and Internet access services in a discounted bundle available on one bill. Since January 2003, we have introduced our Freedom service plans in nearly all of our key markets. As of March 31, 2005, approximately 58% of Verizon's residential customers have purchased local services in combination with either Verizon long distance or Verizon DSL, or both. For small businesses, we have also begun offering Verizon Freedom for Business in eleven markets, covering approximately 84% of business access lines.

*Network Access Services*

Network access services revenues are earned from end-user customers and long distance and other competing carriers who use our local exchange facilities to provide usage services to their customers. Switched access revenues are derived from fixed and usage-based charges paid by carriers for access to our local network. Special access revenues originate from carriers and end-users that buy dedicated local exchange capacity to support their private networks. End-user access revenues are earned from our customers and from resellers who purchase dial-tone services. Further, network access revenues include our DSL services.

In the first quarter of 2005, our network access revenues increased by \$8 million, or 0.3% in the first quarter of 2005 compared to the similar period in 2004, as increased DSL and special access revenues offset the impact of decreasing switched MOUs and access lines, and mandatory price reductions associated with federal and state price cap filings and other regulatory decisions. We added 385,000 new broadband connections (DSL and FiOS) in the first quarter of 2005, for a total of 3.9 million lines at March 31, 2005, representing a 48.0% increase from March 31, 2004. Customer demand for high capacity and digital data services increased 11.6% in the first quarter of 2005 compared to the similar period in 2004. Special access revenue growth reflects continuing demand in the business market for high-capacity, high-speed digital services, partially offset by lessening demand for older, low-speed data products

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and services. Switched MOUs declined in the first quarter of 2005 by 9.3% compared to the similar period in 2004, reflecting the impact of access line loss and wireless substitution.

The FCC regulates the rates that we charge long distance carriers and end-user customers for interstate access services. See *Other Factors That May Affect Future Results* *FCC Regulation and Interstate Rates* for additional information on FCC rulemakings concerning federal access rates, universal service and unbundling of network elements and broadband services.

*Long Distance Services*

Long distance service revenues include both intraLATA toll services and interLATA long distance voice and data services.

Long distance service revenues increased \$83 million, or 8.3% in the first quarter of 2005 compared to the similar period in 2004 principally as a result of customer growth from our interLATA long distance services. As of March 31, 2005, we added approximately 1.9 million long distance lines or an 11.6% increase from March 31, 2004, for a total of 18.0 million long distance lines nationwide. The introduction of our Freedom service plans continues to stimulate growth in long distance services. As of March 31, 2005, approximately 49% of our local wireline customers have chosen Verizon as their long distance carrier.

*Other Services*

Our other services include such services as billing and collections for long distance carriers, public (coin) telephone and customer premises equipment and supply sales. Other services revenues also include services provided by our non-regulated subsidiaries such as data solutions and systems integration businesses.

Revenues from other services in the first quarter of 2005 decreased by \$5 million, or 0.6% in the first quarter of 2005 compared to the similar period in 2004. The revenue increases resulting from higher sales of voice and data customer premises equipment services were more than offset by the dissolution of non-strategic businesses and declines in business volumes related to billing and collection services and public telephone services.

**Operating Expenses**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Cost of services and sales	\$ 3,898	\$ 3,718	4.8%
Selling, general and administrative expense	2,115	2,149	(1.6)
Depreciation and amortization expense	2,187	2,257	(3.1)

\$ 8,200	\$ 8,124	.9
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*Cost of Services and Sales*

Cost of services and sales includes the following costs directly attributable to a service or product: salaries and wages, benefits, materials and supplies, contracted services, network access and transport costs, customer provisioning costs, computer systems support and cost of products sold. Aggregate customer care costs, which include billing and service provisioning, are allocated between cost of services and sales and selling, general and administrative expense.

In the first quarter of 2005, our cost of services and sales increased \$180 million, or 4.8% compared to the similar period in 2004. Costs in this period were impacted by increased pension and other postretirement benefit costs. As of December 31, 2004, Verizon evaluated key employee benefit plan assumptions in response to conditions in the securities markets. The expected rate of return on pension plan assets has been maintained at 8.50%. However, the discount rate assumption has been lowered from 6.25% in 2004 to 5.75% in 2005, consistent with interest rate levels at the end of 2004. Further, there was an increase in the retiree health care cost trend rates. The overall impact of these assumption changes, combined with the impact of lower than expected actual asset returns over the past few years, resulted in pension and other postretirement benefit expense of \$303 million (primarily in cost of services and sales) in the first quarter of 2005, compared to \$214 million in the first quarter of 2004. Also contributing to expense increases in cost of services and sales were higher costs associated with our growth businesses, including a 3,100, or a 2.2% increase in the number of employees as of March 31, 2005 compared to March 31, 2004. These expense

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increases were partially offset by the effect of reduced local interconnection costs, due to our ongoing review of charges from the CLECs.

See **Other Factors That May Affect Future Results** **Intercarrier Compensation** for additional information on FCC rulemakings and other court decisions addressing intercarrier compensation for dial-up connections for Internet-bound traffic.

*Selling, General and Administrative Expense*

Selling, general and administrative expense includes salaries and wages and benefits not directly attributable to a service or product, bad debt charges, taxes other than income, advertising and sales commission costs, customer billing, call center and information technology costs, professional service fees and rent for administrative space.

In the first quarter of 2005, our selling, general and administrative expense decreased by \$34 million, or 1.6% compared to the similar period in 2004 due to lower non-income taxes principally related to gross receipts and property, partially offset by higher pension and benefit costs, as described above, and the impact of a gain on the sale of a small business unit in the prior year.

*Depreciation and Amortization Expense*

In the first quarter of 2005, depreciation and amortization expense decreased by \$70 million, or 3.1% compared to the similar period in 2004. This decrease was mainly driven by a decline in depreciation expense principally due to the effect of lower rates of depreciation, partially offset by growth in depreciable telephone plant. Amortization expense increased \$24 million primarily due to a higher level of capitalized non-network software.

**Segment Income**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Segment Income	\$ 528	\$ 697	(24.2)%

Segment income decreased by \$169 million, or 24.2% in the first quarter of 2005 compared to the similar period in 2004, primarily as a result of the after-tax impact of operating revenues and operating expenses described above. Special and non-recurring items not included in Domestic Telecom's segment income totaled \$418 million for the first quarter of 2004. Special and non-recurring charges included in the first quarter of 2004 related to pension settlement losses for employees that received lump-sum distributions during the quarter under a voluntary separation plan, costs associated with the early retirement of debt and a gain on the sale of an investment.

**Domestic Wireless**

Our Domestic Wireless segment provides wireless voice and data services and equipment sales across the United States. This segment primarily represents the operations of the Verizon Wireless joint venture.

**Operating Revenues**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Wireless sales and services	\$ 7,418	\$ 6,162	20.4%

Domestic Wireless' s total revenues increased by \$1,256 million, or 20.4% in the first quarter of 2005 compared to the similar period in 2004. Service revenue of \$6,557 million increased by \$1,056 million, or 19.2% in the first quarter of 2005 compared to the similar period in 2004. The service revenues increase was primarily due to the 16.8% increase in customers as well as an increase in ARPU of 2.1% to \$49.03. Equipment and other revenue increased by \$200 million, or 30.3% in the first quarter of 2005 compared to the first quarter of 2004 principally as a result of an increase in wireless devices sold.

Our Domestic Wireless segment ended the first quarter of 2005 with 45.5 million customers, compared to 38.9 million customers at the end of the first quarter of 2004. Domestic Wireless added more than 1.6 million customers during the first quarter of 2005, compared to 1.4 million during the first quarter of 2004. Retail gross customer

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additions were 6.5% higher than the first quarter of 2004. Approximately 44.2 million, or more than 97% of our Domestic Wireless customers, subscribe to digital service compared to 95% in the first quarter of 2004. The overall composition of our Domestic Wireless customer base as of March 31, 2005 was 92% retail postpaid, 3% retail prepaid and 5% resellers. In addition, our average monthly churn rate, the rate at which customers disconnect service, was 1.3% compared to 1.6% in the first quarter of 2004.

ARPU increased in the first quarter of 2005 compared to the first quarter of 2004 primarily due to a higher proportion of customers on price plan offerings with higher access charges as well as an increase in data revenue per subscriber. Data revenue increased to \$416 million in the first quarter of 2005 compared to \$200 million in the first quarter of 2004. As of March 31, 2005, data revenue accounted for 6.3% of service revenue, compared to 3.6% as of March 31, 2004. This ARPU increase was partially offset by recent pricing changes to our America's Choice and family share plans.

The increase in equipment revenue was attributed to an increase in wireless devices sold, including color and camera phones with higher retail prices as well as other data devices, driven by an increase in gross retail customer additions as well as equipment upgrades in the first quarter of 2005 compared to the similar period in 2004.

**Operating Expenses**

(Dollars in Millions)	Three Months Ended March 31,		% Change
	2005	2004	
Cost of services and sales	\$ 2,098	\$ 1,658	26.5%
Selling, general and administrative expense	2,630	2,247	17.0
Depreciation and amortization expense	1,150	1,055	9.0
	<u>\$ 5,878</u>	<u>\$ 4,960</u>	18.5

*Cost of Services and Sales*

Cost of services and sales, which are costs to operate the wireless network as well as costs of roaming, long distance and equipment sales, increased by \$440 million, or 26.5% in the first quarter of 2005 compared to the similar period in 2004. The increase was primarily due to higher wireless network costs caused by increased MOUs on the wireless network in the first quarter of 2005 compared to the similar period in 2004, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales increased by 33.9% in the first quarter of 2005 compared to the similar period in 2004. This increase was primarily due to an increase in handsets sold, due to an increase in gross activations and equipment upgrades in the first quarter of 2005 compared to the similar period in 2004.

*Selling, General and Administrative Expense*

Selling, general and administrative expenses increased by \$383 million, or 17.0% in the first quarter of 2005 compared to the similar period in 2004. This increase was primarily due to a \$162 million increase in salary and benefits expense in the first quarter of 2005 compared to the



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similar period in 2004, due to both higher per employee salary and benefits costs, driven by an increase in costs in the first quarter of 2005 of \$111 million related to our long-term incentive program, and an increase in our number of employees, primarily in the sales and customer care areas. Advertising and promotion expenses increased by \$97 million in the first quarter of 2005 compared to the similar period in 2004. Also contributing to this increase in expenses was a \$43 million aggregate increase in sales commissions in our direct and indirect channels in the first quarter of 2005 compared to the similar period in 2004, primarily related to the increase in gross activations and equipment upgrades in the first quarter of 2005 compared to the first quarter of 2004.

### *Depreciation and Amortization Expense*

Depreciation and amortization increased by \$95 million, or 9.0% in the first quarter of 2005 compared to the similar period in 2004. This increase was primarily due to increased depreciation expense related to the increase in depreciable assets.

**Table of Contents****Segment Income**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Segment Income	\$ 433	\$ 318	36.2%

Segment income increased by \$115 million, or 36.2% in the first quarter of 2005 compared to the similar period in 2004 primarily as a result of the after-tax impact of operating revenues and operating expenses described above, partially offset by an increase in minority interest. The increase in minority interest was principally due to the increase in the earnings of the Domestic Wireless segment, which has a significant minority interest attributable to Vodafone.

**Information Services**

Information Services multi-platform business comprises SuperPages, our print yellow pages directories, SuperPages.com, our online directory and search services, and SuperPages On the Go, our directory and information services on wireless telephones.

In 2004, Verizon sold Verizon Information Services Canada, its directory operations in Canada, to an affiliate of Bain Capital, a private investment firm, for \$1.6 billion. Prior years' results of operations for this business unit are classified as discontinued operations in accordance with SFAS No. 144, and are excluded from Information Services segment results.

**Operating Revenues**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Operating Revenues	\$ 897	\$ 919	(2.4)%

Operating revenues in the first quarter of 2005 decreased \$22 million, or 2.4% compared to the similar period in 2004. The decrease was primarily due to reduced domestic print advertising revenue. SuperPages.com continued to achieve strong growth as demonstrated by an increase in revenue of 25% for the first quarter of 2005 compared to the similar period in 2004.

**Operating Expenses**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Cost of services and sales	\$ 156	\$ 135	15.6%

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Selling, general and administrative expense	284	320	(11.3)
Depreciation and amortization expense	23	21	9.5
	<u>\$ 463</u>	<u>\$ 476</u>	(2.7)

Cost of services and sales in the first quarter of 2005 increased \$21 million, or 15.6% compared to the similar period in 2004. This increase was primarily due to higher printing and distribution costs and higher costs associated with our domestic Internet directory service. Selling, general and administrative expenses in the first quarter of 2005 decreased \$36 million, or 11.3% compared to the similar period in 2004. This decrease was primarily due to reduced bad debt, collection fees, and other cost reductions, partially offset by higher costs associated with pension and benefits.

**Segment Income**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Segment Income	\$ 271	\$ 271	%

Segment income of \$271 million in the first quarter of 2005 was unchanged from the first quarter of 2004 primarily as a result of the after-tax impact of the operating revenues and expenses described above offset by reduced interest and income tax expense. Special and non-recurring items not included in Information Services segment income totaled \$(8) million in the first quarter of 2004, related to the operations of Verizon Information Services Canada,

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partially offset by pension settlement losses for employees that received lump-sum distributions during the quarter under a voluntary separation plan. There were no special or non-recurring items in the first quarter of 2005.

**International**

Our International segment includes investments in international wireline and wireless telecommunication operations primarily in the Americas and Europe. Our consolidated international investments as of March 31, 2005 included Verizon Dominicana, C. por A. (Verizon Dominicana) in the Dominican Republic, TELPRI in Puerto Rico, and Micronesian Telecommunications Corporation in the Northern Mariana Islands. Either the cost or the equity method is applied to those investments in which we have less than a controlling interest.

**Operating Revenues**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Operating Revenues	\$ 517	\$ 468	10.5%

Revenues generated by our international businesses increased by \$49 million, or 10.5% in the first quarter of 2005 compared to the similar period in 2004. The increase in 2005 was primarily due to the appreciation of the Dominican Republic peso as well as operational growth at Verizon Dominicana.

**Operating Expenses**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Cost of services and sales	\$ 177	\$ 147	20.4%
Selling, general and administrative expense	157	128	22.7
Depreciation and amortization expense	84	77	9.1
	<u>\$ 418</u>	<u>\$ 352</u>	18.8

*Cost of Services and Sales*

Cost of services and sales increased \$30 million, or 20.4% in the first quarter of 2005 compared to the similar period in 2004. This increase primarily reflects higher variable costs at TELPRI as well as the appreciation of the Dominican Republic peso.

*Selling, General and Administrative Expense*

Selling, general and administrative expenses increased \$29 million, or 22.7% in the first quarter of 2005 compared to the similar period in 2004. This increase primarily reflects the appreciation of the Dominican Republic peso.

*Depreciation and Amortization Expense*

Depreciation and amortization expense increased \$7 million, or 9.1% in the first quarter of 2005 compared to the similar period in 2004. This increase primarily reflects the appreciation of the Dominican Republic peso.

**Segment Income**

(Dollars in Millions)	Three Months Ended March 31,		
	2005	2004	% Change
Segment Income	\$ 351	\$ 281	24.9%

Segment income increased by \$70 million, or 24.9% in the first quarter of 2005 compared to the similar period in 2004. The 2005 increase in segment income was primarily due to higher results at Verizon Dominicana driven by favorable foreign currency and operational growth, as well as the increase in income from other unconsolidated businesses partially offset by a decrease in equity in earnings of unconsolidated businesses.

Equity in earnings of unconsolidated businesses decreased by \$14 million, or 5.9% in the first quarter of 2005 compared to the similar period in 2004. This decrease reflects lower equity income from our investment in TELUS due to our sale of that investment in 2004, partially offset by operational growth at Vodafone Omnitel.

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Income from other unconsolidated businesses increased in 2005 by \$27 million, or 93.1% in the first quarter of 2005 compared to the similar period in 2004. The increase reflects higher gains realized in the first quarter of 2005 from the sale of investments compared to the similar period in 2004.

Special and non-recurring items not included in International's segment income totaled \$1 million for the first quarter of 2004 related to pension settlement losses for employees that received lump-sum distributions during the quarter under a voluntary separation plan.

**Special Items****Severance, Pension and Benefit Charges**

During the first quarter of 2004, we recorded pretax pension settlement losses of \$728 million (\$446 million after-tax, or \$.16 per diluted share) related to employees that received lump-sum distributions during the quarter in connection with the 2003 voluntary separation plan under which more than 21,000 employees accepted the separation offer in the fourth quarter of 2003. This charge was recorded in accordance with SFAS No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, which requires that settlement losses be recorded once prescribed payment thresholds have been reached.

**Sale of Investment**

During the first quarter of 2004, we sold all of our investment in Iowa Telecom preferred stock, which resulted in a pretax gain of \$43 million (\$43 million after-tax, or \$.02 per diluted share) included in Income From Other Unconsolidated Businesses in the unaudited condensed consolidated statements of income.

**Other Special Items**

During the first quarter of 2004, we recorded pretax charges of \$43 million (\$27 million after-tax, or \$.01 per diluted share) resulting from the early retirement of debt.

**Consolidated Financial Condition**

(Dollars in Millions)	Three Months Ended March 31,		\$ Change
	2005	2004	
<b>Cash Flows Provided By (Used In)</b>			
Operating activities	\$ 3,936	\$ 4,042	\$ (106)
Investing activities	(4,312)	(2,088)	(2,224)
Financing activities	(1,222)	(2,048)	826
<b>Decrease in Cash and Cash Equivalents</b>	<b>\$ (1,598)</b>	<b>\$ (94)</b>	<b>\$ (1,504)</b>

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We use the net cash generated from our operations to fund network expansion and modernization, repay external financing, pay dividends and invest in new businesses. Additional external financing is utilized when necessary. While our current liabilities typically exceed current assets, our sources of funds, primarily from operations and, to the extent necessary, from readily available external financing arrangements, are sufficient to meet ongoing operating and investing requirements. We expect that capital spending requirements will continue to be financed primarily through internally generated funds. Additional debt or equity financing may be needed to fund additional development activities or to maintain our capital structure to ensure our financial flexibility.

### **Cash Flows Provided By Operating Activities**

Our primary source of funds continues to be cash generated from operations. The decrease in cash from operating activities in the first quarter of 2005 compared to the similar period in 2004 was primarily due to higher pension fund contributions, minority interest dividends paid and income taxes paid in the first quarter of 2005 related to fourth quarter 2004 sales of Verizon Information Services Canada and TELUS shares. In addition, we recorded higher severance payments in the first quarter of 2004 related to the 2003 voluntary separation plan, partially offset by income tax refunds.

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### **Cash Flows Used In Investing Activities**

Capital expenditures continue to be our primary use of capital resources and facilitate the introduction of new products and services, enhance responsiveness to competitive challenges and increase the operating efficiency and productivity of our networks. Including capitalized software, we invested \$1,892 million in our Domestic Telecom business in the first quarter of 2005 compared to \$1,282 million in the similar period in 2004. We also invested \$1,641 million in our Domestic Wireless business in the first quarter of 2005 compared to \$1,314 million in the similar period in 2004. The increase in capital spending of both Domestic Telecom and Domestic Wireless represents our continuing effort to invest in high growth areas including wireless, long distance, DSL and other wireline data initiatives.

Capital spending, including capitalized software, is expected to increase by approximately 10% in 2005.

We invested \$1,178 million in acquisitions and investments in businesses during the first quarter of 2005, including \$677 million primarily to acquire 63 broadband wireless licenses in connection with FCC auction 58, \$418 million to purchase Qwest Wireless, LLC's spectrum licenses and wireless network assets in several existing and new markets and \$49 million for other wireless properties. During the first quarter of 2004, we invested \$34 million in acquisitions and investments in businesses primarily related to Verizon's limited partnership investments in entities that invest in affordable housing projects. In addition, in the first quarter of 2004, we received cash proceeds of \$117 million from the sale of a small business unit.

Other, net investing activities in the first quarter of 2005 includes cash proceeds of \$102 million from the sale of a small international investment. Other, net investing activities in the first quarter of 2004 includes net cash proceeds received in connection with the sale of investments, including Iowa Telecom preferred stock.

Under the terms of an investment agreement, Vodafone may require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times at its then fair market value. In the event Vodafone exercises its put rights, we have the right, exercisable at our sole discretion, to purchase up to \$12.5 billion of Vodafone's interest instead of Verizon Wireless for cash or Verizon stock at our option. Vodafone had the right to require the purchase of up to \$10 billion during a 61-day period opening on June 10 and closing on August 9 in 2004, and did not exercise that right. As a result, Vodafone still has the right to require the purchase of up to \$20 billion worth of its interest, not to exceed \$10 billion in any one year, during a 61-day period opening on June 10 and closing on August 9 in 2005 through 2007. Vodafone also may require that Verizon Wireless pay for up to \$7.5 billion of the required repurchase through the assumption or incurrence of debt.

### **Cash Flows Used In Financing Activities**

Cash of \$42 million was used to reduce our total debt during the first quarter of 2005. We repaid \$377 million of Domestic Telecom long-term debt, partially offset by increases in our short-term borrowings by \$334 million.

Cash of \$977 million was used to reduce our total debt during the first quarter of 2004. We repaid \$1,993 million of Domestic Telecom long-term debt, partially offset by increases in our short-term borrowings by \$572 million. In addition, Verizon Global Funding Corp. issued \$500 million of long-term debt.



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Our ratio of debt to debt combined with shareowners' equity was 50.8% at March 31, 2005 compared to 57.0% at March 31, 2004.

As of March 31, 2005, we had \$93 million in bank borrowings outstanding. In addition, we had approximately \$5.8 billion of unused bank lines of credit and our financing subsidiary had shelf registrations for the issuance of up to \$10.5 billion of unsecured debt securities. The debt securities of our telephone and financing subsidiaries continue to be accorded high ratings by primary rating agencies. In September 2004, Standard & Poor's affirmed the long term debt rating of Verizon and related entities, including Verizon Wireless at A+, and changed our credit rating outlook to negative from stable. The short-term debt rating of Verizon Network Funding Corp. was lowered to A-1 from A-1+. In December 2004, Moody's Investors Service (Moody's) affirmed the A2 rating of Verizon Global Funding and the P-1 short-term rating of Verizon Network Funding. In February 2005, both Standard & Poor's and Moody's indicated that the proposed acquisition of MCI (see "Other Factors That May Affect Future Results - Recent Developments") may result in downgrades in Verizon's debt ratings. Moody's placed the long- and short-term debt of Verizon and its telephone subsidiaries on review for possible downgrade, while simultaneously changing the outlook on the A3-rated Verizon Wireless debt to stable from positive. Standard & Poor's placed the long-term debt of Verizon and affiliates (including Verizon Wireless) on credit watch with negative implications. Fitch Ratings also placed the A+ rating of Verizon, along with the ratings of its affiliates, on ratings watch negative as a result of the proposed acquisition of MCI.

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We and our consolidated subsidiaries are in compliance with all of our debt covenants.

As in prior quarters, dividend payments were a significant use of capital resources. We determine the appropriateness of the level of our dividend payments on a periodic basis by considering such factors as long-term growth opportunities, internal cash requirements and the expectations of our shareowners. In the first quarter of 2005, Verizon increased its dividend by \$.02 per share, or 5.2% to \$.405 per share compared to \$.385 per share declared in the first quarter of 2004.

### **Decrease in Cash and Cash Equivalents**

Our cash and cash equivalents at March 31, 2005 totaled \$692 million, a \$1,598 million decrease from cash and cash equivalents at December 31, 2004 of \$2,290 million. The decrease in cash and cash equivalents was primarily driven by increased capital spending and higher acquisitions and investments, partially offset by lower debt repayment activity.

## **Market Risk**

We are exposed to various types of market risk in the normal course of our business, including the impact of interest rate changes, foreign currency exchange rate fluctuations, changes in equity investment prices and changes in corporate tax rates. We employ risk management strategies using a variety of derivatives, including interest rate swap agreements, interest rate locks, foreign currency forwards and equity options. We do not hold derivatives for trading purposes.

It is our general policy to enter into interest rate, foreign currency and other derivative transactions only to the extent necessary to achieve our desired objectives in limiting our exposures to the various market risks. Our objectives include maintaining a mix of fixed and variable rate debt to lower borrowing costs within reasonable risk parameters and to protect against earnings and cash flow volatility resulting from changes in market conditions. We do not hedge our market risk exposure in a manner that would completely eliminate the effect of changes in interest rates, equity prices and foreign exchange rates on our earnings. We do not expect that our net income, liquidity and cash flows will be materially affected by these risk management strategies.

### **Foreign Currency Translation**

The functional currency for our foreign operations is the local currency. The translation of income statement and balance sheet amounts of these entities into U.S. dollars are recorded as cumulative translation adjustments, which are included in Accumulated Other Comprehensive Loss in our unaudited condensed consolidated balance sheets. At March 31, 2005, our primary translation exposure was to the Venezuelan bolivar, Dominican Republic peso and the euro. We have not hedged our accounting translation exposure to foreign currency fluctuations relative to the carrying value of these investments.

Our earnings were affected by foreign currency gains or losses associated with the U. S. dollar denominated assets and liabilities at Verizon Dominicana.

## **Other Factors That May Affect Future Results**

## Recent Developments

### MCI Acquisition

On February 14, 2005, Verizon announced that it had agreed to acquire MCI, Inc. for a combination of Verizon common shares and cash (including MCI dividends). On May 2, 2005, Verizon announced that it agreed with MCI to further amend its agreement to acquire MCI for cash and stock of at least \$26.00 per share, consisting of cash of \$5.60, which is expected to be paid as a special dividend by MCI soon after the approval of the transaction by MCI shareholders, plus the greater of .5743 Verizon shares for each MCI common share or a sufficient number of Verizon shares to deliver to shareholders \$20.40 of value. Under this price protection feature, Verizon may elect to pay additional cash instead of issuing additional shares over the .5743 exchange ratio. This consideration is subject to adjustment at closing and may be decreased based on MCI's bankruptcy claims-related experience and international tax liabilities. The MCI board of directors has unanimously agreed to recommend approval of the amended

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agreement to its shareholders. In addition to MCI shareholder approval, the acquisition requires regulatory approvals, which the companies are targeting to obtain by year-end 2005.

Separately, on April 9, 2005, Verizon announced an agreement had been reached with eight entities affiliated with Carlos Slim Helu to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash. Under the agreement, Verizon will pay the Slim entities an adjustment at the end of one year in an amount per MCI share equal to 0.7241 times the amount by which the price of Verizon's common stock exceeds \$35.52 per share to a maximum of \$62.50 (measured over a 20-day period) plus an additional cash amount of 3% per annum from April 9, 2005 until the closing of the purchase of those shares. The purchase, which is subject to regulatory approvals, is expected to close in the second quarter of 2005.

## **Spectrum Purchases**

On February 24, 2005, we signed an agreement with MetroPCS, Inc. to purchase 10 MHz of personal communications services spectrum covering the San Francisco area for a purchase price of \$230 million. The transaction is subject to the approval of the FCC and the U.S. Department of Justice, and is expected to close in the second quarter of 2005.

On February 15, 2005, the FCC's auction of broadband personal communications services licenses ended and Verizon Wireless and Vista PCS, LLC were the highest bidders for 63 licenses totaling approximately \$697 million.

On November 4, 2004, we announced the signing of a definitive agreement with NextWave to purchase all of NextWave's remaining personal communications services spectrum licenses in 23 markets for \$3,000 million through the purchase of stock of NextWave following the completion of its bankruptcy reorganization, when it will own no assets other than the licenses. The 10 MHz and 20 MHz licenses, in the 1.9 GHz personal communications services frequency range, cover a population of 73 million people and will be used to expand Verizon Wireless's network capacity in 22 key existing markets, including New York, Boston, Washington, D.C. and Los Angeles, as well as to expand into Tulsa, Oklahoma. The transaction has been approved by the U.S. Department of Justice, the U.S. Bankruptcy Court and the FCC. The transaction closed in April 2005.

## **Sales of Businesses and Investments**

### *Telephone Access Lines*

In October 2004, Verizon announced that it had suspended discussions with potential buyers related to its upstate New York access lines, pending an evaluation of its strategic options. However, we are continuing to consider plans for a reduction in the size of our access line business, including through a spin-off mechanism or otherwise, so that we may pursue our strategy of placing greater focus on the higher growth businesses of broadband and wireless. These plans have been delayed until the outcome of the MCI acquisition process has been resolved.

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During the second quarter of 2004, we entered into an agreement to sell our wireline-related businesses in Hawaii, which operates 707,000 switched access lines, for \$1,650 million in cash, less debt. In connection with obtaining approval of the Hawaii Public Utilities Commission, The Carlyle Group agreed to contribute additional equity to the Hawaii businesses. Consequently, Verizon agreed to reduce the selling price to \$1,600 million, less debt. The FCC, the U.S. Department of Justice and the Hawaii Public Utilities Commission have provided the necessary approvals. The transaction closed on May 2, 2005.

### **Environmental Matters**

During 2003, under a government-approved plan, remediation of the site of a former facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s commenced. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. In addition, a reassessment of costs related to remediation efforts at several other former facilities was undertaken. As a result, an additional environmental remediation expense of \$240 million was recorded in 2003.

### **New York Recovery Funding**

In August 2002, President Bush signed the Supplemental Appropriations bill that included \$5.5 billion in New York recovery funding. Of that amount, approximately \$750 million has been allocated to cover utility restoration and infrastructure rebuilding as a result of the September 11th terrorist attacks. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 30, 2004, we have applied for reimbursement of approximately \$266 million. We received an advance of \$11 million in December 2003 and an additional advance of \$77 million in June 2004. We are awaiting the results of an audit

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relating to the total amount that we have applied for reimbursement, including funds already received. On December 22, 2004, we applied for reimbursement of an additional \$136 million of category 2 losses and on March 29, 2005 we amended our application seeking an additional \$3 million. Category 2 funding is for permanent restoration and infrastructure improvement. According to the plan, permanent restoration is reimbursed up to 75% of the loss. Our application is pending.

## **Regulatory and Competitive Trends**

### **Competition and the Telecommunications Act of 1996**

We face increasing competition in all areas of our business. The Telecommunications Act of 1996 (1996 Act), regulatory and judicial actions and the development of new technologies, products and services have created opportunities for alternative telecommunication service providers, many of which are subject to fewer regulatory constraints. Current and potential competitors in telecommunications services include long distance companies, other local telephone companies, cable companies, wireless service providers, foreign telecommunications providers, electric utilities, Internet service providers, providers of VoIP services and other companies that offer network services. Many of these companies have a strong market presence, brand recognition and existing customer relationships, all of which contribute to intensifying competition and may affect our future revenue growth.

We are unable to predict definitively the impact that the ongoing changes in the telecommunications industry will ultimately have on our business, results of operations or financial condition. The financial impact will depend on several factors, including the timing, extent and success of competition in our markets, the timing and outcome of various regulatory proceedings and any appeals, and the timing, extent and success of our pursuit of new opportunities resulting from the 1996 Act and technological advances.

### **FCC Regulation and Interstate Rates**

Our telephone operations are subject to the jurisdiction of the FCC with respect to interstate services and related matters.

#### *Access Charges and Universal Service*

On May 31, 2000, the FCC adopted the Coalition for Affordable Local and Long Distance Services (CALLS) plan as a comprehensive five-year plan for regulation of interstate access charges. The CALLS plan has three main components. First, it establishes portable interstate access universal service support of \$650 million for the industry that replaces implicit support previously embedded in interstate access charges. Second, the plan simplifies the patchwork of common line charges into one subscriber line charge (SLC) and provides for de-averaging of the SLC by zones and class of customers. Third, the plan set into place a mechanism to transition to a set target of \$.0055 per minute for switched access services. Once that target rate is reached, local exchange carriers are no longer required to make further annual price cap reductions to their switched access prices. The annual reductions leading to the target rate, as well as annual reductions for the subset of special access services that remain subject to price cap regulation was set at 6.5% per year.

As a result of tariff adjustments which became effective in July 2003, virtually all of our switched access lines reached the \$.0055 benchmark. On June 29, 2004, the U.S. Court of Appeals for the D.C. Circuit upheld the FCC's prior approval of an increase in the SLC cap. The current cap

is \$6.50.

The FCC previously initiated investigations of the interstate access rates charged by Verizon's local telephone companies during the 1993 to 1996 tariff years under the price cap rules in effect at that time. On July 30, 2004, the FCC released an order resolving one of the issues in those pending investigations, and concluded that some of Verizon's local telephone companies had incorrectly calculated the impact of their obligation to share a portion of their earnings above certain prescribed levels with their access customers. The amount of any refund as a result of that finding will be determined in a further phase of the proceeding. On March 30, 2005 the FCC found that there was no liability on the remaining issues, and closed the investigation.

The FCC has adopted rules for special access services that provide for pricing flexibility and ultimately the removal of services from price regulation when prescribed competitive thresholds are met. Approximately 55% of special access revenues are now removed from price regulation.

The FCC also has established a mechanism to provide universal service support to high-cost areas served by larger, non-rural local telephone companies. This funding mechanism provides additional support for local telephone services in several states served by our telephone operations. This system has been supplemented by the new FCC access charge plan described above. On October 16, 2003, in response to a previous court decision, the FCC

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announced a decision providing additional justification for its non-rural high-cost universal support mechanism and modifying it in part. That decision has been reversed by the U.S. Court of Appeals for the Tenth Circuit and remanded to the FCC on the grounds that the FCC has still not adequately justified its decision. The FCC's rules remain in effect pending the completion of any remand proceedings. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. Any change in the current assessment mechanism could result in a change in the contribution that local telephone companies must make and that would have to be collected from customers.

### *Unbundling of Network Elements*

On February 20, 2003, the FCC announced a decision adopting new rules defining the obligations of incumbent local exchange carriers to provide competing carriers with access to elements of their local networks on an unbundled basis, known as UNEs. The decision was the culmination of an FCC rulemaking referred to as its triennial review of its UNE rules, and also was in response to a decision by the U.S. Court of Appeals for the D.C. Circuit that had overturned the FCC's previous unbundling rules.

The text of the order and accompanying rules were released on August 21, 2003. With respect to broadband facilities, such as mass market fiber to the premises loops and packet switching, that order generally removed unbundling obligations under Section 251 of the 1996 Act. With respect to narrowband services, the order generally left unbundling obligations in place, with certain limited exceptions, and delegated to state regulatory proceedings a further review. The order also provided a new set of criteria relating to when carriers may purchase a combination of unbundled loops and transport elements known as enhanced extended loops (EELs) that increased arbitrage opportunities by making it easier for carriers to use EELs purchased at artificially low regulated UNE rates rather than competitive special access prices.

Multiple parties, including Verizon, appealed various aspects of the decision. On March 2, 2004, the U.S. Court of Appeals for the D.C. Circuit issued an order upholding the FCC in part, and overturning its order in part. The court upheld the FCC with respect to broadband facilities. On the narrowband unbundling requirements, the court reversed and vacated key aspects of the FCC decision that had required unbundled access to mass market switching and high capacity transmission facilities. The court's order vacating those aspects of the FCC's rules went into effect on June 16, 2004, and petitions by various parties to obtain a stay or U.S. Supreme Court review were denied.

On August 20, 2004, the FCC issued interim narrowband unbundling rules and a Notice of Proposed Rulemaking to establish new unbundling rules. In the interim rules order, the FCC required incumbent carriers to continue providing, for six months from the effective date of its order, unbundled mass market switching and high capacity transmission facilities on the same terms that they were available under interconnection agreements as of June 15, 2004.

On February 4, 2005, the FCC released a decision on new unbundling rules. The FCC eliminated the requirement to unbundle mass market local switching on a nationwide basis, with the obligation to accept new orders ending as of the effective date of the order (March 11, 2005). The FCC also established a one year transition for existing UNE switching arrangements. For high capacity transmission facilities, the FCC established criteria for determining whether high capacity loops, transport or dark fiber transport must be unbundled in individual wire centers, and stated that these standards were only expected to affect a small number of wire centers. The FCC also eliminated the obligation to provide dark fiber loops and found that there is no obligation to provide UNEs exclusively for wireless or long distance service. In any instance where a particular high capacity facility no longer has to be made available as a UNE, the FCC established a similar one year transition for any existing high capacity loop or transport UNEs, and an 18 month transition for any existing dark fiber UNEs. Verizon and other parties have challenged various aspects of the new FCC rules on appeal.



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Separately, the FCC has taken steps to clarify its rules for broadband facilities in response to requests of various parties. Verizon petitioned the FCC to make clear that any broadband facilities that do not have to be unbundled under Section 251 of the 1996 Act also do not have to be unbundled under another provision of the 1996 Act, specifically Section 271. On October 22, 2004, the FCC granted that petition, and the FCC's decision has been appealed by various parties. In addition, the FCC has clarified that mass market fiber to the curb loops qualify for the same regulatory treatment as mass market fiber to the premises loops, that fiber loops to serve customers in multiple unit buildings also qualify for that same regulatory treatment as long as the building is predominantly residential, and that carriers that deploy new broadband network facilities are not required to equip those facilities with legacy capabilities that could render them subject to unbundling.

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### *Intercarrier Compensation*

In March 2005, the FCC released a further notice of proposed rulemaking on intercarrier compensation including, but not limited to, access charges, compensation for Internet traffic, and reciprocal compensation for local traffic. The notice seeks comments about intercarrier compensation in general, and requests input on seven specific reform proposals.

The FCC also has pending before it issues relating to intercarrier compensation for dial-up Internet-bound traffic. The FCC previously found this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the 1996 Act. Instead, the FCC established federal rates per minute for this traffic that declined from \$.0015 to \$.0007 over a three-year period, established caps on the total minutes of this traffic subject to compensation in a state, and required incumbent local exchange carriers to offer to both bill and pay reciprocal compensation for local traffic at the same rate as they are required to pay on Internet-bound traffic. On May 3, 2002, the U.S. Court of Appeals for the D.C. Circuit rejected part of the FCC's rationale, but declined to vacate the order while it is on remand. As a result, pending further action by the FCC, the FCC's underlying order remains in effect. On October 8, 2004, the FCC announced that it had denied a petition to discontinue the \$.0007 rate cap on this traffic, but had decided to remove the caps on the total minutes of Internet-bound traffic subject to compensation. That decision is the subject of an appeal by several parties. Disputes also remain pending in a number of forums relating to the appropriate compensation for Internet-bound traffic during previous periods under the terms of our interconnection agreements with other carriers.

On March 10, 2004, the FCC initiated a rulemaking proceeding to address the regulation of services that use Internet protocol, including voice services. The FCC also considered several petitions asking whether, and under what circumstances, services that employ Internet protocol are subject to access charges. The FCC concluded in response to one such petition that one provider's peer-to-peer Internet protocol service that does not use the public switched network is an interstate information service and is not subject to access charges. The FCC issued an order in connection with another such petition that stated that the petitioning company's service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service subject to access charges. A third petition asking the FCC to forbear from applying access charges to voice over Internet protocol services that are terminated on switched local exchange networks was withdrawn by the carrier that filed that petition. In addition, the FCC granted a petition filed by one provider of a voice over Internet protocol service and declared its service to be jurisdictionally interstate in nature on the grounds that it was impossible to separate that carrier's Internet protocol service into interstate and intrastate components. The FCC also stated that its conclusion would apply to other services with similar characteristics. That order has been appealed.

### *Broadband Services*

The FCC has several ongoing rulemakings considering the regulatory treatment of broadband services. Among the questions at issue are whether to require local telephone companies like Verizon to offer such services as a common carrier or whether such services may be offered under a less regulated private carriage arrangement, under what circumstances high speed Internet access services should be classified as largely deregulated information services, and whether to declare broadband services offered by local telephone companies as non-dominant and what the effect should be of any such classification.

### **Recent Accounting Pronouncement**

In March 2005, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 47, *Accounting for Conditional Asset Retirement Obligations*—an interpretation of FASB Statement No. 143. FIN No. 47 clarifies SFAS No. 143, *Accounting for Asset Retirement Obligations*, such that conditional asset retirement obligations require recognition at fair value if they can be reasonably estimated. These rules are effective December 31, 2005; we are currently evaluating the impact, if any, on our results of operations and financial position.



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**Cautionary Statement Concerning Forward-Looking Statements**

In this Management's Discussion and Analysis of Results of Operations and Financial Condition, and elsewhere in this Quarterly Report, we have made forward-looking statements. These statements are based on our estimates and assumptions and are subject to risks and uncertainties. Forward-looking statements include the information concerning our possible or assumed future results of operations. Forward-looking statements also include those preceded or followed by the words "anticipates," "believes," "estimates," "hopes" or similar expressions. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The following important factors, along with those discussed elsewhere in this Quarterly Report, could affect future results and could cause those results to differ materially from those expressed in the forward-looking statements:

materially adverse changes in economic and industry conditions and labor matters, including workforce levels and labor negotiations, and any resulting financial and/or operational impact, in the markets served by us or by companies in which we have substantial investments;

material changes in available technology;

technology substitution;

an adverse change in the ratings afforded our debt securities by nationally accredited ratings organizations;

the final results of federal and state regulatory proceedings concerning our provision of retail and wholesale services and judicial review of those results;

the effects of competition in our markets;

the timing, scope and financial impacts of our deployment of fiber-to-the-premises broadband technology;

the ability of Verizon Wireless to continue to obtain sufficient spectrum resources;

changes in our accounting assumptions that regulatory agencies, including the SEC, may require or that result from changes in the accounting rules or their application, which could result in an impact on earnings;

a significant change in the timing of, or the imposition of any government conditions to, the closing of our business combination transaction with MCI, Inc., if consummated;

actual and contingent liabilities in connection with the MCI transaction; and

the extent and timing of our ability to obtain revenue enhancements and cost savings following the MCI transaction.



**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Information relating to market risk is included in Item 2, Management's Discussion and Analysis of Results of Operations and Financial Condition in the section under the caption Market Risk.

**Item 4. Controls and Procedures**

Our chief executive officer and chief financial officer have evaluated the effectiveness of the registrant's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934), as of the end of the period covered by this quarterly report, that ensure that information relating to the registrant which is required to be disclosed in this report is recorded, processed, summarized and reported, within required time periods. Based on this evaluation, our chief executive officer and chief financial officer have concluded that the registrant's disclosure controls and procedures were adequate and effective to ensure that material information relating to the registrant and its consolidated subsidiaries would be accumulated and communicated to them by others within those entities, particularly during the period in which this quarterly report was being prepared, to allow timely decisions regarding required disclosure. There were no changes in the registrant's internal control over financial reporting during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

**Part II Other Information****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information about Verizon's common stock repurchases during the first quarter of 2005.

Period	Total Number of Shares Purchased	Average Price	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares
		Paid per Share		that May Yet Be Purchased Under the Plans or Programs (2)
January 2005	175,000	\$39.99	175,000	70,285,200
February 2005	1,280,000	35.90	1,280,000	69,005,200
March 2005	1,820,000	35.64	1,820,000	67,185,200
	<u>3,275,000</u>	35.97	<u>3,275,000</u>	67,185,200

(1) On January 22, 2004, Verizon's Board of Directors authorized a common stock repurchase program.

(2) The program authorizes total repurchases of up to 80 million common shares and expires no later than the close of business on February 28, 2006. Under the plan, Verizon has the option to repurchase shares for the corporation over time, with the amount and timing of

repurchases depending on market conditions and corporate needs.

**Item 6. Exhibits**

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(a) Exhibits:

Exhibit Number	
10a	Verizon Communications Inc. Long-Term Incentive Plan Restricted Stock Unit Agreement 2005-07 Award Cycle.
10b	Verizon Communications Inc. Long-Term Incentive Plan Performance Stock Unit Agreement 2005-07 Award Cycle.
12	Computation of Ratio of Earnings to Fixed Charges.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**Signature**

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Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

VERIZON COMMUNICATIONS INC.

Date: May 9, 2005

By /s/ David H. Benson

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David H. Benson

Senior Vice President and Controller

(Principal Accounting Officer)

UNLESS OTHERWISE INDICATED, ALL INFORMATION IS AS OF MAY 4, 2005.