

VERIZON COMMUNICATIONS INC
Form 10-Q
November 06, 2006
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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 September 30, 2006

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)

23-2259884
(I.R.S. Employer Identification No.)

140 West Street
New York, New York
(Address of principal executive offices)

10007
(Zip Code)

Registrant's telephone number (212) 395-1000

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 a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer Accelerated filer Non-accelerated filer

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

At September 30, 2006, 2,919,515,293 shares of the registrant's Common Stock were outstanding, after deducting 48,137,145 shares held in treasury.

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Verizon Communications Inc. and Subsidiaries

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|-------------|--|-------------|
| | 2006 | 2005 | 2006 | 2005 |
| (Dollars in Millions, Except Per Share Amounts) (Unaudited) | | | | |
| Operating Revenues | \$ 23,254 | \$ 18,486 | \$ 67,990 | \$ 54,221 |
| Operating Expenses | | | | |
| Cost of services and sales (exclusive of items shown below) | 8,982 | 6,361 | 26,349 | 18,390 |
| Selling, general and administrative expense | 6,720 | 5,195 | 19,587 | 15,382 |
| Depreciation and amortization expense | 3,628 | 3,433 | 10,947 | 10,219 |
| Sales of businesses, net | | | | (530) |
| Total Operating Expenses | 19,330 | 14,989 | 56,883 | 43,461 |
| Operating Income | 3,924 | 3,497 | 11,107 | 10,760 |
| Equity in earnings of unconsolidated businesses | 288 | 182 | 616 | 553 |
| Other income and (expense), net | 101 | 88 | 264 | 290 |
| Interest expense | (572) | (525) | (1,798) | (1,601) |
| Minority interest | (1,088) | (748) | (2,942) | (2,069) |
| Income Before Provision For Income Taxes, Discontinued Operations and Cumulative Effect of Accounting Change | 2,653 | 2,494 | 7,247 | 7,933 |
| Provision for income taxes | (855) | (702) | (2,421) | (2,386) |
| Income Before Discontinued Operations and Cumulative Effect of Accounting Change | 1,798 | 1,792 | 4,826 | 5,547 |
| Income from discontinued operations, net of tax | 124 | 77 | 381 | 192 |
| Cumulative effect of accounting change, net of tax | | | (42) | |
| Net Income | \$ 1,922 | \$ 1,869 | \$ 5,165 | \$ 5,739 |
| Basic Earnings Per Common Share⁽¹⁾ | | | | |
| Income before discontinued operations and cumulative effect of accounting change | \$.62 | \$.65 | \$ 1.66 | \$ 2.00 |
| Income from discontinued operations, net of tax | .04 | .03 | .13 | .07 |
| Cumulative effect of accounting change, net of tax | | | (.01) | |
| Net Income | \$.66 | \$.68 | \$ 1.77 | \$ 2.07 |
| Weighted-average shares outstanding (in millions) | 2,907 | 2,765 | 2,911 | 2,767 |

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Diluted Earnings Per Common Share⁽¹⁾

| | | | | |
|--|---------|---------|----------|----------|
| Income before discontinued operations and cumulative effect of accounting change | \$.62 | \$.64 | \$ 1.65 | \$ 1.98 |
| Income from discontinued operations, net of tax | .04 | .03 | .13 | .07 |
| Cumulative effect of accounting change, net of tax | | | (.01) | |
| Net Income | \$.66 | \$.67 | \$ 1.76 | \$ 2.05 |
| Weighted-average shares outstanding (in millions) | 2,923 | 2,817 | 2,945 | 2,818 |
| Dividends declared per common share | \$.405 | \$.405 | \$ 1.215 | \$ 1.215 |

⁽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 September 30, 2006 | At December 31, 2005 |
|--|-----------------------|----------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 1,846 | \$ 776 |
| Short-term investments | 1,589 | 2,498 |
| Accounts receivable, net of allowances of \$1,265 and \$1,190 | 10,834 | 8,784 |
| Inventories | 1,650 | 1,714 |
| Assets held for sale | 3,597 | 3,336 |
| Prepaid expenses and other | 2,099 | 2,168 |
| Total current assets | 21,615 | 19,276 |
| | | |
| Plant, property and equipment | 201,967 | 188,278 |
| Less accumulated depreciation | 120,565 | 115,125 |
| | 81,402 | 73,153 |
| | | |
| Investments in unconsolidated businesses | 4,478 | 4,604 |
| Wireless licenses | 48,318 | 47,781 |
| Goodwill | 5,709 | 392 |
| Other intangible assets, net | 5,220 | 4,193 |
| Other assets | 18,937 | 18,731 |
| Total assets | \$ 185,679 | \$ 168,130 |
| | | |
| Liabilities and Shareowners Investment | | |
| Current liabilities | | |
| Debt maturing within one year | \$ 11,529 | \$ 6,688 |
| Accounts payable and accrued liabilities | 14,501 | 12,066 |
| Liabilities related to assets held for sale | 2,065 | 1,865 |
| Other | 7,218 | 5,551 |
| Total current liabilities | 35,313 | 26,170 |
| | | |
| Long-term debt | 30,154 | 31,569 |
| Employee benefit obligations | 20,231 | 18,198 |
| Deferred income taxes | 21,905 | 22,715 |
| Other liabilities | 4,274 | 3,363 |
| Minority interest | 27,523 | 26,435 |
| | | |
| Shareowners investment | | |
| Series preferred stock (\$.10 par value; none issued) | | |
| Common stock (\$.10 par value; 2,967,652,438 shares and 2,774,865,381 shares issued) | 297 | 277 |

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| | | |
|--|-------------------|-------------------|
| Contributed capital | 31,423 | 25,369 |
| Reinvested earnings | 17,471 | 15,905 |
| Accumulated other comprehensive loss | (1,516) | (1,783) |
| Common stock in treasury, at cost | (1,575) | (353) |
| Deferred compensation employee stock ownership plans and other | 179 | 265 |
| Total shareowners investment | 46,279 | 39,680 |
| Total liabilities and shareowners investment | \$ 185,679 | \$ 168,130 |

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) | Nine Months Ended September 30, | |
|---|--|-------------|
| | 2006 | 2005 |
| Cash Flows from Operating Activities | | |
| Net Income | \$ 5,165 | \$ 5,739 |
| Adjustments to reconcile net income to net cash provided by operating activities continuing operations: | | |
| Depreciation and amortization | 10,947 | 10,219 |
| Sales of businesses, net | | (530) |
| Employee retirement benefits | 1,500 | 1,231 |
| Deferred income taxes | (540) | (945) |
| Provision for uncollectible accounts | 916 | 982 |
| Equity in earnings of unconsolidated businesses | (616) | (553) |
| Cumulative effect of accounting change, net of tax | 42 | |
| Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses | (1,601) | (1,916) |
| Other, net | 2,123 | 773 |
| Net cash provided by operating activities continuing operations | 17,936 | 15,000 |
| Net cash provided by operating activities discontinued operations | 315 | 275 |
| Net cash provided by operating activities | 18,251 | 15,275 |
| Cash Flows from Investing Activities | | |
| Capital expenditures (including capitalized software) | (12,318) | (11,363) |
| Acquisitions, net of cash acquired, and investments | 1,037 | (4,630) |
| Proceeds from disposition of businesses | | 1,326 |
| Net change in short-term investments | 1,521 | 938 |
| Other, net | 576 | 293 |
| Net cash used in investing activities continuing operations | (9,184) | (13,436) |
| Net cash used in investing activities discontinued operations | (138) | (189) |
| Net cash used in investing activities | (9,322) | (13,625) |
| Cash Flows from Financing Activities | | |
| Proceeds from long-term borrowings | 3,958 | 1,486 |
| Repayments of long-term borrowings and capital lease obligations | (8,706) | (2,371) |
| Increase in short-term obligations, excluding current maturities | 1,831 | 1,109 |
| Dividends paid | (3,537) | (3,308) |
| Proceeds from sale of common stock | 115 | 37 |
| Purchase of common stock for treasury | (1,348) | (221) |
| Other, net | 5 | 30 |
| Net cash used in financing activities continuing operations | (7,682) | (3,238) |
| Net cash used in financing activities discontinued operations | (177) | (86) |

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| | | |
|--|----------|---------|
| Net cash used in financing activities | (7,859) | (3,324) |
| Increase (decrease) in cash and cash equivalents | 1,070 | (1,674) |
| Cash and cash equivalents, beginning of period | 776 | 2,290 |
| Cash and cash equivalents, end of period | \$ 1,846 | \$ 616 |

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

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, 2005.

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

2. Acquisitions

Completion of Merger with MCI

On February 14, 2005, Verizon announced that it agreed to acquire 100% of the outstanding common stock of MCI, Inc. (MCI) for a combination of Verizon common shares and cash. MCI was a global communications company that provided Internet, data and voice communication services to businesses and government entities throughout the world and consumers in the United States. After receiving the required state, federal and international regulatory approvals, Verizon and MCI closed the merger on January 6, 2006.

On April 9, 2005, Verizon entered into a stock purchase agreement with eight entities affiliated with Carlos Slim Helú to purchase 43.4 million shares of MCI common stock for \$25.72 per share in cash plus an additional cash amount of 3% per annum from April 9, 2005, until the closing of the purchase of those shares. The transaction closed on May 17, 2005. The total cash payment was \$1,121 million and the investment was accounted for as a cost investment. No payments were made under a provision that required Verizon to pay an additional amount at the end of one year to the extent that the price of Verizon's common stock exceeded \$35.52 per share. We received the special dividend of \$5.60 per MCI share on these 43.4 million MCI shares, or \$243 million, on October 27, 2005.

Under the terms of the merger agreement, MCI shareholders received .5743 shares of Verizon common stock (\$5,050 million in the aggregate) and cash of \$2.738 (\$779 million in the aggregate) for each of their MCI shares. The merger consideration was equal to \$20.40 per MCI share, excluding the \$5.60 per share special dividend paid by MCI to its shareholders on October 27, 2005. There was no purchase price adjustment.

The merger was accounted for using the purchase method in accordance with the Financial Accounting Standards Board Statement of Financial Accounting Standard (SFAS) No. 141, *Business Combinations* (SFAS No. 141), and the aggregate transaction value was \$6,889 million, consisting of the cash and common stock issued at closing (\$5,829 million), the consideration for the shares acquired from the Carlos Slim Helú entities, net of the special dividend paid by MCI (\$973 million) and closing and other direct merger-related costs, including financial advisory, legal and accounting services. The number of shares issued was based on the Average Parent Stock Price, as defined in the merger agreement. The consolidated financial statements include the results of MCI's operations from the date of the close of the merger.

Prior to the merger, there were commercial transactions between us and the former MCI entities for telecommunications services at rates comparable to similar transactions with other third parties. Subsequent to the merger, these transactions are eliminated in consolidation.

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Reasons for the Merger

We believe that the merger will make us a more efficient competitor in providing a broad range of communications services and will result in several significant strategic benefits to us, including the following:

Strategic Position. Following the merger, it is expected that our core strengths in communication services will be enhanced by MCI's employee and business customer base, portfolio of advanced data and IP services and network assets.

Growth Platform. MCI's presence in the U.S. and international enterprise sector and its long haul fiber network infrastructure are expected to provide us with a stronger platform from which we can market our products and services.

Operational Benefits. We believe that we will achieve operational benefits through, among other things, eliminating duplicative staff and information and operation systems and to a lesser extent overlapping network facilities; reducing procurement costs; using the existing networks more efficiently; reducing line support functions; reducing general and administrative expenses; improving information systems; optimizing traffic flow; eliminating planned or potential Verizon capital expenditures for new long-haul network capability; and offering wireless capabilities to MCI's customers.

Allocation of the cost of the merger

In accordance with SFAS No. 141, the cost of the merger was preliminarily allocated to the assets acquired and liabilities assumed based on their fair values as of the close of the merger, with the amounts exceeding the fair value being recorded as goodwill. The process to identify and record the fair value of assets acquired and liabilities assumed included an analysis of the acquired fixed assets, including real and personal property; various contracts, including leases, contractual commitments, and other business contracts; customer relationships; investments; and contingencies.

The fair values of the assets acquired and liabilities assumed were preliminarily determined using one or more of three valuation approaches: market, income and cost. The selection of a particular method for a given asset depended on the reliability of available data and the nature of the asset, among other considerations. The market approach, which indicates value for a subject asset based on available market pricing for comparable assets, was utilized for certain acquired real property and investments. The income approach, which indicates value for a subject asset based on the present value of cash flow projected to be generated by the asset, was used for certain intangible assets such as customer relationships, as well as for favorable/unfavorable contracts. Projected cash flow is discounted at a required rate of return that reflects the relative risk of achieving the cash flow and the time value of money. Projected cash flows for each asset considered multiple factors, including current revenue from existing customers; distinct analysis of expected price, volume, and attrition trends; reasonable contract renewal assumptions from the perspective of a marketplace participant; expected profit margins giving consideration to marketplace synergies; and required returns to contributory assets. The cost approach, which estimates value by determining the current cost of replacing an asset with another of equivalent economic utility, was used for the majority of personal property. The cost to replace a given asset reflects the estimated reproduction or replacement cost for the property, less an allowance for loss in value due to depreciation or obsolescence, with specific consideration given to economic obsolescence if indicated.

As a result of the preliminary allocation of the cost of the merger, we recorded the assets acquired and liabilities assumed from MCI at their respective fair values as of the close of the merger. As the values of certain assets and liabilities are preliminary in nature, they are subject to adjustment as additional information is obtained, including, but not limited to, valuation and physical counts of property, plant and equipment, deferred taxes, the resolution of pre-acquisition tax and other contingencies, exiting certain contractual arrangements and the expected plans to rationalize the combined workforce. The valuations will be finalized within 12 months of the close of the merger. When the valuations are finalized, any changes to the preliminary valuation of assets acquired or liabilities assumed may result in material adjustments to the fair value of the identifiable intangible assets acquired and goodwill.

The following table summarizes the current preliminary allocation of the cost of the merger to the assets acquired, including cash of \$2,361 million, and liabilities assumed as of the close of the merger. Certain of the amounts in the following table have been revised since the initial allocation to reflect information that has since become available. These amounts will likely continue to change until the valuation is finalized.

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(Dollars in Millions)

| | |
|---|-----------------|
| Assets acquired | |
| Current assets | \$ 5,978 |
| Property, plant & equipment | 6,453 |
| Intangible assets subject to amortization | |
| Customer relationships | 1,162 |
| Rights of way and other | 202 |
| Deferred income taxes and other assets | 1,790 |
| Goodwill | 5,051 |
| Total assets acquired | 20,636 |
| Liabilities assumed | |
| Current liabilities | 6,047 |
| Long-term debt | 6,169 |
| Deferred income taxes and other non-current liabilities | 1,531 |
| Total liabilities assumed | 13,747 |
| Purchase price | \$ 6,889 |

The goodwill resulting from the merger with MCI was assigned to the Wireline segment, which includes the operations of the former MCI. The customer relationships are being amortized on a straight-line basis over 3-8 years based on whether the relationship is with a consumer or a business customer since this correlates to the pattern in which the economic benefits are expected to be realized.

In connection with the merger, we recorded \$190 million of severance and severance-related costs and \$382 million of contract termination costs in the above allocation of the cost of the merger in accordance with the Emerging Issues Task Force Issue (EITF) No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. We expect to pay \$158 million of the severance and severance-related costs in 2006 with the remaining costs to be paid in 2007. We expect to pay \$129 million of contract termination costs in 2006 and the remaining costs will be paid over the remaining contract periods through 2009. The following table summarizes the obligations recognized in connection with the MCI merger and the activity to date:

| | (Dollars in Millions) | | | |
|--|-----------------------|----------|-----------------------------|----------------|
| | Beginning Balance | Payments | Other Increases (Decreases) | Ending Balance |
| Severance costs and contract termination costs | \$ 459 | \$ (113) | \$ 113 | \$ 459 |

Pro Forma Information

The following unaudited pro forma consolidated results of operations assume that the MCI merger was completed as of January 1 for the periods shown below:

| (Dollars in Millions, Except Per Share Amounts) | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2006 | Nine Months Ended September 30, 2005 |
|--|--|---|---|
| Revenues | \$ 22,454 | \$ 68,217 | \$ 66,614 |
| Income before discontinued operations and cumulative effect of accounting change | \$ 2,120 | \$ 4,826 | \$ 5,953 |
| Net income | \$ 2,193 | \$ 5,165 | \$ 6,227 |
| Basic earnings per common share: | | | |
| | \$.72 | \$ 1.66 | \$ 2.03 |

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| | | | |
|--|--------|---------|---------|
| Income before discontinued operations and cumulative effect of accounting change | | | |
| Net income | \$.75 | \$ 1.77 | \$ 2.13 |
| Diluted earnings per common share: | | | |
| Income before discontinued operations and cumulative effect of accounting change | \$.72 | \$ 1.65 | \$ 2.01 |
| Net income | \$.74 | \$ 1.76 | \$ 2.10 |

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The unaudited pro forma information presents the combined operating results of Verizon and the former MCI, with the results prior to the acquisition date adjusted to include the pro forma impact of: the elimination of transactions between Verizon and the former MCI; the adjustment of amortization of intangible assets and depreciation of fixed assets based on the preliminary purchase price allocation; the elimination of merger expenses incurred by the former MCI; the elimination of the loss on the early redemption of MCI's debt; the adjustment of interest expense reflecting the redemption of all of MCI's debt and the replacement of that debt with \$4 billion of new debt issued in February 2006 at Verizon's weighted average borrowing rate; and to reflect the impact of income taxes on the pro forma adjustments utilizing Verizon's statutory tax rate of 40%. The unaudited pro forma results for the three and nine months ended September 30, 2005 include (\$4) million, and \$82 million, respectively, for discontinued operations that were sold by MCI during the first quarter of 2005. The unaudited pro forma results for the three and nine months ended September 30, 2005 include \$188 million of net tax benefits resulting from tax reserve adjustments recognized by the former MCI in the third quarter of 2005, including audit settlements and other activity in the period.

The unaudited pro forma consolidated basic and diluted earnings per share for the nine months ended September 30, 2006 and the three and nine months ended September 30, 2005 are based on the consolidated basic and diluted weighted average shares of Verizon and the former MCI. The historical basic and diluted weighted average shares of the former MCI were converted for the actual number of shares issued upon the closing of the merger.

The unaudited pro forma results are presented for illustrative purposes only and do not reflect the realization of potential cost savings, or any related integration costs. Certain cost savings may result from the merger; however, there can be no assurance that these cost savings will be achieved. Cost savings, if achieved, could result from, among other things, the reduction of overhead expenses, including employee levels and the elimination of duplicate facilities and capital expenditures. These pro forma results do not purport to be indicative of the results that would have actually been obtained if the merger occurred as of the beginning of each of the periods presented, nor does the pro forma data intend to be a projection of results that may be obtained in the future.

Other Acquisitions

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East. As a result of acquiring Price's limited partnership interest, Verizon recorded goodwill of \$345 million in the third quarter of 2006 attributable to its Domestic Wireless segment.

We also completed other immaterial acquisitions in our Verizon Wireless and Information Services segments.

3. Stock-Based Compensation

Effective January 1, 2006, we adopted SFAS No. 123(R), *Share-Based Payment* utilizing the modified prospective method. SFAS No. 123(R) requires the measurement of stock-based compensation expense based on the fair value of the award on the date of grant. Under the modified prospective method, the provisions of SFAS No. 123(R) apply to all awards granted or modified after the date of adoption. The impact to Verizon primarily resulted from Verizon Wireless, for which we recorded a \$42 million cumulative effect of accounting change as of January 1, 2006, net of taxes and after minority interest, to recognize the effect of initially measuring the outstanding liability for Value Appreciation Rights (VARs) of the Verizon Wireless joint venture, at fair value utilizing a Black-Scholes model.

Previously, effective January 1, 2003, we adopted the fair value recognition provisions of 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*) for all new awards granted, modified or settled after January 1, 2003.

Table of Contents*Verizon Communications Long Term Incentive Plan*

The Verizon Communications Long Term Incentive Plan (the Plan), effective January 1, 2001, permits the grant of nonqualified stock options, incentive stock options, restricted stock, restricted stock units, performance shares, performance share units and other awards. The maximum number of shares for awards is 200 million.

Restricted Stock Units

The Plan provides for grants of restricted stock units (RSUs) that vest at the end of the third year of the grant. The RSUs are classified as liability awards because the RSUs will be paid in cash upon vesting. The RSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the performance of Verizon's stock.

Included in Verizon's stock-based compensation expense in the third quarter of 2006 and for the nine months ended September 30, 2006 is a portion of the cost related to restricted stock granted in 2006, 2005 and 2004.

Changes in Verizon's Restricted Stock Units outstanding for the nine months ended September 30, 2006 were as follows:

| (Shares in Thousands) | Restricted Stock Units | Weighted Average |
|---|------------------------|-----------------------|
| | | Grant-Date Fair Value |
| Outstanding restricted stock units at beginning of year | 6,869 | \$ 36.12 |
| Granted | 8,322 | 31.73 |
| Cancellations/Forfeitures | (344) | 35.29 |
| Outstanding restricted stock units, September 30, 2006 | 14,847 | \$ 33.67 |

Performance Share Units

The Plan also provides for grants of performance share units (PSU) that vest at the end of the third year of the grant. The 2006, 2005 and 2004 performance share units will be paid in cash upon vesting. The 2003 PSUs were paid out in February 2006 in Verizon shares.

The target award is determined at the beginning of the period and can increase (to a maximum 200% of the target) or decrease (to zero) based on a key performance measure, Total Shareholder Return (TSR). At the end of the period, the PSU payment is determined by comparing Verizon's TSR to the TSR of a predetermined peer group and the S&P 500 companies. All payments are subject to approval by the Board's Compensation Committee. The PSUs are classified as liability awards because the PSU awards will be paid in cash upon vesting. The PSU award liability is measured at its fair value at the end of each reporting period and, therefore, will fluctuate based on the performance of Verizon's stock as well as Verizon's TSR relative to the peer group's TSR and S&P 500 TSR.

Changes in Verizon's Performance Share Units outstanding for the nine months ended September 30, 2006 were as follows:

| (Shares in Thousands) | Performance Share Units | Weighted Average |
|--|-------------------------|-----------------------|
| | | Grant-Date Fair Value |
| Outstanding performance share units at beginning of period | 19,091 | \$ 36.84 |

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| | | |
|---|---------|----------|
| Granted | 12,734 | 31.82 |
| Payments | (3,607) | 38.54 |
| Cancellations/Forfeitures | (1,089) | 37.56 |
| Outstanding performance share units, September 30, 2006 | 27,129 | \$ 34.23 |

As of September 30, 2006, unrecognized compensation expense related to the unvested portion of Verizon's RSUs and PSUs was approximately \$504 million and is expected to be recognized over a weighted-average period of approximately 2 years.

Table of Contents*MCI Restricted Stock Plan*

MCI's Management Restricted Stock Plan (MRSP) provides for the granting of stock-based compensation to management. Following the acquisition by Verizon on January 6, 2006, awards outstanding under the MRSP were converted into 3,456,108 shares of Verizon common stock in accordance with the Merger Agreement. MCI has not issued new MRSP shares since February 2005.

Changes in the MRSP's restricted stock outstanding for the nine months ended September 30, 2006 were as follows:

| (Shares in Thousands) | Restricted Stock | Weighted Average Grant-Date Fair Value |
|---|-------------------------|---|
| Outstanding restricted stock at beginning of year | | \$ |
| Acquisition by Verizon | 3,456 | 30.75 |
| Payments | (2,530) | 30.75 |
| Cancellations/Forfeitures | (46) | 30.75 |
| Outstanding restricted stock, September 30, 2006 | 880 | \$ 30.75 |

As of September 30, 2006, unrecognized compensation expense related to the unvested portion of the MRSP restricted stock was approximately \$12 million and is expected to be recognized over a weighted-average period of approximately 2 years.

Verizon Wireless Long-Term Incentive Plan

The 2000 Verizon Wireless Long-Term Incentive Plan (the Wireless Plan) provides compensation opportunities to eligible employees and other participating affiliates of the Cellco Partnership, d.b.a. Verizon Wireless (the Partnership). The Wireless Plan provides rewards that are tied to the long-term performance of the Partnership. Under the Wireless Plan, Value Appreciation Rights (VARs) are granted to eligible employees. The aggregate number of VARs that may be issued under the Wireless Plan is approximately 343 million. The Company has not issued new VARs since 2004.

VARs reflect the change in the value of the Partnership, as defined in the Wireless Plan, similar to stock options. Once VARs become vested, employees can exercise their VARs and receive a payment that is equal to the difference between the VAR price on the date of grant and the VAR price on the date of exercise, less applicable taxes. VARs are fully exercisable three years from the date of grant with a maximum term of 10 years. All VARs are granted at a price equal to the estimated fair value of the Partnership, as defined in the Wireless Plan, at the date of the grant.

With the adoption of SFAS No. 123(R), the Partnership began estimating the fair value of VARs granted using a Black-Scholes option valuation model. The following table summarizes the assumptions used in the model during the three and nine months ended September 30, 2006:

| | Ranges |
|--------------------------|---------------|
| Risk-free rate | 4.7% - 5.2% |
| Expected term (in years) | 1.3 - 3.5 |
| Expected volatility | 17.6% - 22.3% |
| Expected dividend yield | n/a |

The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected term of the VARs granted was estimated using a combination of the simplified method as prescribed in Staff Accounting Bulletin (SAB) No. 107, Share Based Payments, historical experience, and management judgment. Expected volatility was based on a blend of the historical and implied volatility of publicly traded peer companies for a period equal to the VARs expected life, ending on the day of the grant, and calculated on a monthly basis. The

Partnership does not pay dividends.

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Changes in the VARs outstanding for the nine months ended September 30, 2006 were as follows:

| | VARs | Weighted Average Grant-Date Fair Value |
|---|-------------|---|
| (Shares in Thousands) | | |
| Outstanding rights at beginning of year | 108,923 | \$ 17.12 |
| Exercised | (5,836) | 12.77 |
| Cancellations/Forfeitures | (6,327) | 23.40 |
| Outstanding rights, September 30, 2006 | 96,760 | \$ 16.97 |

As of September 30, 2006, unrecognized compensation expense related to the unvested portion of the VARs was approximately \$95 million and is expected to be recognized over a weighted-average period of less than one year.

Other Stock-Based Compensation Expense

After-tax compensation expense for other stock based compensation including RSUs, PSUs, MRSPs and VARs described above included in net income as reported for the three and nine months ended September 30, 2006 was \$187 million and \$433 million, respectively. For the three and nine months ended September 30, 2005, after-tax compensation expense for other stock based compensation was \$116 million and \$315 million, respectively.

Stock Options

The Verizon Long Term Incentive Plan provides for grants of stock options to employees at an option price per share of 100% of the fair market value of Verizon Stock on the date of grant. Each grant has a 10 year life, vesting equally over a three year period, starting at the date of the grant. We have not granted new stock options since 2004.

Included in Verizon's stock-based compensation expense for the nine months ended September 30, 2006 is the applicable portion of the cost related to 2003 stock option grants. The stock options granted before 2003 were fully vested as of the beginning of 2005.

Changes in Verizon's stock options outstanding for the nine months ended September 30, 2006 were as follows:

| | Stock Options | Weighted Average Exercise Price |
|---|--------------------------|--|
| (Shares in Thousands) | | |
| Options outstanding, beginning of year | 250,976 | \$ 47.62 |
| Exercised | (1,689) | 32.28 |
| Cancelled | (22,044) | 44.53 |
| Options outstanding, September 30, 2006 | 227,243 | \$ 48.03 |
| Options exercisable, September 30, 2006 | 222,702 | \$ 48.26 |

The weighted average remaining contractual term was 4.1 years for stock options outstanding and exercisable as of September 30, 2006. The total intrinsic value was approximately \$19 million for stock options outstanding and exercisable as of September 30, 2006. The total intrinsic value for stock options exercised during the nine months ended September 30, 2006 was \$4.7 million. The total intrinsic value for stock options exercised during the nine months ended September 30, 2005 was \$6.4 million.

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For the three and nine months ended September 30, 2006, the amount of cash received from the exercise of stock options was approximately \$46 million and \$53 million, respectively, and the related tax benefits for the three and nine months ended September 30, 2006 were approximately \$1.6 million and \$1.8 million, respectively. For the three and nine months ended September 30, 2005, the amount of cash received from the exercise of stock options was approximately \$6 million and \$33 million, respectively, and the related tax benefits were approximately \$0.1 million and \$2.4 million, respectively.

For the three and nine months ended September 30, 2006, after-tax compensation expense for stock options was \$6 million and \$24 million, respectively. For the three and nine months ended September 30, 2005, after-tax compensation expense for stock options was \$16 million and \$46 million, respectively.

As of September 30, 2006, unrecognized compensation expense related to the unvested portion of stock options was approximately \$14 million and is expected to be recognized over the next six months.

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4. Strategic Actions

Merger Integration Costs

During the three and nine months ended September 30, 2006, we recorded pretax charges of \$25 million (\$16 million after-tax) and \$157 million (\$99 million after-tax), respectively, related to integration costs associated with the MCI merger that closed on January 6, 2006. These costs are primarily comprised of advertising and other costs related to re-branding initiatives and systems integration activities. There were no similar charges incurred during the comparable periods in 2005.

Facility and Employee-Related Items

During the three and nine months ended September 30, 2006, we recorded pretax charges of \$48 million (\$31 million after-tax) and \$138 million (\$88 million after-tax), respectively, in connection with the relocation of several functions to Verizon Center.

During the third quarter of 2006, we recorded net pretax pension settlement losses of \$29 million (\$17 million after-tax), related to employees that received lump-sum distributions during 2006 primarily resulting from our separation plans. These charges were 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. There were no similar items incurred during the comparable period in 2005.

During the second quarter of 2006, we recorded pretax charges of \$300 million (\$186 million after-tax), for employee severance and severance-related costs in connection with the involuntary separation of approximately 3,200 employees, the majority of whom were separated in the second and third quarters. The remaining employees will be separated during the fourth quarter of 2006.

During the third quarter of 2005, we recorded a net pretax gain of \$64 million (\$37 million after-tax) in connection with the relocation of several functions to Verizon Center, including a pretax gain of \$120 million (\$72 million after-tax) related to the sale of a New York City office building, partially offset by a pretax charge of \$56 million (\$35 million after-tax) primarily associated with relocation-related employee severance costs and related activities.

Tax Matters

During the third quarter of 2005, we recorded a tax benefit of \$94 million in connection with capital gains and prior year investment losses and a tax benefit of \$21 million related to the repatriation of prior year foreign earnings.

During the second quarter of 2005, as a result of the capital gain realized in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million related to capital losses incurred in previous years.

Also during the second quarter of 2005, we recorded a net tax provision of \$232 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, for two of Verizon's foreign investments. There were no similar tax matters during the comparable periods in 2006.

Other Special Items

During the third quarter of 2005, we recorded a pretax impairment charge of \$125 million (\$125 million after-tax) pertaining to our leasing operations for aircraft leases involved in recent airline bankruptcy proceedings. There were no similar items incurred during the comparable period in 2006.

5. Discontinued Operations and Sales of Businesses, Net

Discontinued Operations

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Verizon Dominicana C. por A. and Telecomunicaciones de Puerto Rico, Inc.

During the second quarter of 2006, we reached definitive agreements to sell our interests in our Caribbean and Latin American telecommunications operations in three separate transactions to América Móvil, S.A. de C.V. (América Móvil), a wireless service provider throughout Latin America, and a company owned jointly by Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil. We have agreed to sell our 100 percent indirect interest in

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Verizon Dominicana C. por A. (Verizon Dominicana) and our 52 percent interest in Telecomunicaciones de Puerto Rico, Inc. (TELPRI) to América Móvil. An entity jointly owned by América Móvil and Telmex has agreed to purchase our indirect 28.5 percent interest in Compañía Anónima Nacional Teléfonos de Venezuela (CANTV).

Upon closing, the transactions are expected to result in pretax proceeds of approximately \$3,700 million, prior to purchase price adjustments as defined in the sale agreements. Each transaction is subject to separate regulatory approvals and none of the sales is contingent on the closing of any of the other transactions. We expect to close the sale of our interest in TELPRI in 2006 or 2007. In September 2006, we extended the expiration date of the Verizon Dominicana and CANTV transactions until December 29, 2006. The transactions are expected to close subject to the receipt of regulatory approvals. Although we anticipate pretax gains on the transactions, in the case of Verizon Dominicana, the U.S. taxes that will become payable and be recorded at the time the transaction closes will significantly exceed the amount of the pretax gain. In addition, the government tax authority in the Dominican Republic has issued an assessment of capital gains tax in connection with the proposed transaction. We believe that the assessment is without merit, have filed an appeal and are contesting it vigorously. We are unable to predict the ultimate outcome of this proceeding or its effect on the transaction.

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 Dominicana and TELPRI as discontinued operations in the unaudited condensed consolidated statements of income. In addition, the assets and liabilities of Verizon Dominicana and TELPRI are aggregated and disclosed as current assets and current liabilities in the unaudited condensed consolidated balance sheets. Our investment in CANTV continues to be accounted for as an equity method investment in continuing operations. Additional detail related to the assets and liabilities of Verizon Dominicana and TELPRI are as follows:

| (Dollars in Millions) | At September 30, 2006 | At December 31, 2005 |
|------------------------------------|-----------------------|----------------------|
| Current assets | \$ 467 | \$ 508 |
| Plant, property and equipment, net | 2,223 | 2,152 |
| Other non-current assets | 907 | 676 |
| Total assets | \$ 3,597 | \$ 3,336 |
| Current liabilities | \$ 350 | \$ 758 |
| Long-term debt | 575 | 300 |
| Other non-current liabilities | 1,140 | 807 |
| Total liabilities | \$ 2,065 | \$ 1,865 |

Related to the assets and liabilities above is \$881 million and \$897 million included as Accumulated Other Comprehensive Loss in the Condensed Consolidated Balance Sheets as of September 30, 2006 and December 31, 2005, respectively, comprised of foreign currency translation adjustments and minimum pension liability adjustments.

Income from discontinued operations, net of tax presented in the Condensed Consolidated Statements of Income included the following:

| (Dollars in Millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|--------------|---------------------------------|---------------|
| | 2006 | 2005 | 2006 | 2005 |
| Operating Revenues | \$ 544 | \$ 551 | \$ 1,759 | \$ 1,565 |
| Income from operations | 198 | 113 | 598 | 304 |
| Provision for income taxes | (74) | (36) | (217) | (112) |
| Income from discontinued operations, net of tax | \$ 124 | \$ 77 | \$ 381 | \$ 192 |

Sales of Businesses, Net

Verizon Hawaii Inc.

During the second quarter of 2005, we recorded a pretax gain of \$530 million (\$336 million after-tax) related to the sale of our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operated approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services Inc. in Hawaii, to an affiliate of The Carlyle Group.

Table of Contents**6. Goodwill and Other Intangible Assets***Goodwill*

Changes in the carrying amount of goodwill for the nine months ended September 30, 2006, were as follows:

| (Dollars in Millions) | Wireline | Wireless | Information Services | Total |
|--------------------------------------|----------|----------|-------------------------|----------|
| Balance at December 31, 2005 | \$ 315 | \$ | \$ 77 | \$ 392 |
| Acquisitions | 5,051 | 345 | | 5,396 |
| Reclassifications and other | (75) | | (4) | (79) |
| Balance at September 30, 2006 | \$ 5,291 | \$ 345 | \$ 73 | \$ 5,709 |

Other Intangible Assets

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

| (Dollars in Millions) | At September 30, 2006 | | At December 31, 2005 | |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: | | | | |
| Customer lists and relationships (3 to 8 years) | \$ 1,294 | \$ 236 | \$ 3,436 | \$ 3,279 |
| Non-network internal-use software (1 to 7 years) | 7,965 | 4,013 | 7,377 | 3,365 |
| Other (1 to 25 years) | 229 | 19 | 27 | 3 |
| Total | \$ 9,488 | \$ 4,268 | \$ 10,840 | \$ 6,647 |
| Unamortized intangible assets: | | | | |
| Wireless licenses | \$ 48,318 | | \$ 47,781 | |

Customer lists and relationships of \$3,313 million became fully amortized and were written-off during the second quarter of 2006. Amortization expense was \$337 million and \$1,127 million for the three and nine months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005, amortization expense was \$374 million and \$1,109 million, respectively. Amortization expense is estimated to be \$340 million for the remainder of 2006, \$1,195 million in 2007, \$1,034 million in 2008, \$832 million in 2009 and \$620 million in 2010.

7. Debt*Redemption of Debt Assumed in Merger*

On January 17, 2006, Verizon announced offers to purchase two series of MCI senior notes, MCI \$1,983 million aggregate principal amount of 6.688% Senior Notes Due 2009 and MCI \$1,699 million aggregate principal amount of 7.735% Senior Notes Due 2014, at 101% of their par value. Due to the change in control of MCI that occurred in connection with the merger with Verizon on January 6, 2006, Verizon was required to make this offer to noteholders within 30 days of the closing of the merger. Noteholders tendered \$165 million of the 6.688% Senior Notes. Separately, Verizon notified noteholders that MCI was exercising its right to redeem both series of Senior Notes prior to maturity under the optional redemption procedures provided in the indentures. The 6.688% Notes were redeemed on March 1, 2006, and the 7.735% Notes were redeemed on February 16, 2006.

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In addition, on January 20, 2006, Verizon announced an offer to repurchase MCI \$1,983 million aggregate principal amount of 5.908% Senior Notes Due 2007 at 101% of their par value. On February 21, 2006, \$1,804 million of these notes were redeemed by Verizon. Verizon satisfied and discharged the indenture governing this series of notes shortly after the close of the offer for those noteholders who did not accept this offer.

We recorded pretax charges of \$26 million (\$16 million after-tax) during the first quarter of 2006 resulting from the extinguishment of debt assumed in connection with the completion of the MCI merger described above.

Other Debt Redemptions/Prepayments

During the second quarter of 2006, we redeemed/prepaid several debt issuances, including: Verizon North Inc. \$200 million 7.625% Series C debentures due May 15, 2026; Verizon Northwest Inc. \$175 million 7.875% Series B

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debentures due June 1, 2026; Verizon South Inc. \$250 million 7.5% Series D debentures due March 15, 2026; Verizon California Inc. \$25 million 9.41% Series W first mortgage bonds due 2014; Verizon California Inc. \$30 million 9.44% Series X first mortgage bonds due 2015; Verizon Northwest Inc. \$3 million 9.67% Series HH first mortgage bonds due 2010 and Contel of the South Inc. \$14 million 8.159% Series GG first mortgage bonds due 2018. The gain/(loss) from these retirements was immaterial.

During the third quarter of 2005, we redeemed Verizon New England Inc. \$250 million 6.875% debentures due October 1, 2023 resulting in a pretax charge of \$10 million (\$6 million after-tax) in connection with the early extinguishment of the debt.

Zero-Coupon Convertible Notes

Previously, Verizon Global Funding issued approximately \$5,442 million in principal amount at maturity of zero-coupon convertible notes due 2021 which were callable by Verizon on or after May 15, 2006. On May 15, 2006, we redeemed the remaining \$1,375 million accreted principal of the remaining outstanding zero-coupon convertible notes at a redemption price of \$639.76 per \$1,000 principal plus interest of approximately \$0.5767 per \$1,000 principal. The total payment on the date of redemption was approximately \$1,377 million.

Issuance of Debt

In February 2006, Verizon issued \$500 million of 5.35% notes due 2011, \$1,250 million of 5.55% notes due 2016, \$500 million of 5.85% notes due 2035 and \$1,750 million of floating rate notes due 2007 resulting in cash proceeds of \$3,958 million, net of discounts, issuance costs and the receipt of cash proceeds related to hedges on the interest rate of an anticipated financing.

Support Agreements and Guarantees

All of Verizon Global Funding's debt had the benefit of Support Agreements between us and Verizon Global Funding, which gave 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 did not have recourse to the stock or assets of most of our telephone operations; however, they did have recourse to dividends paid to us by any of our consolidated subsidiaries as well as assets not covered by the exclusion. On February 1, 2006, Verizon announced the merger of Verizon Global Funding into Verizon. As a result of the merger, all of Verizon Global Funding's debt has been assumed by Verizon by operation of law.

In addition, Verizon Global Funding had 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. In connection with the merger of Verizon Global Funding into Verizon, Verizon has assumed this guarantee. As of September 30, 2006, \$2,950 million principal amount of these obligations remained outstanding.

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 September 30, 2006, \$92 million principal amount of this obligation remained outstanding. NYNEX and GTE no longer issue public debt or file SEC reports. See Note 12 for information on guarantees of operating subsidiary debt listed on the New York Stock Exchange.

Debt Covenants

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

8. Comprehensive Income

Comprehensive income consists of net income and other gains and losses affecting shareowners' investment that, under accounting principles generally accepted in the United States, are excluded from net income.

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

| (Dollars in Millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|----------|---------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Net Income | \$ 1,922 | \$ 1,869 | \$ 5,165 | \$ 5,739 |
| Other Comprehensive Income (Loss), Net of Taxes | | | | |
| Foreign currency translation adjustments | (36) | (96) | 210 | (641) |
| Unrealized gains on net investment hedges | | | | 2 |
| Unrealized derivative gains on cash flow hedges | | 3 | 13 | 6 |
| Unrealized gains (losses) on marketable securities | 17 | (4) | 31 | (23) |
| Minimum pension liability adjustment | | | 13 | (1) |
| | (19) | (97) | 267 | (657) |
| Total Comprehensive Income | \$ 1,903 | \$ 1,772 | \$ 5,432 | \$ 5,082 |

The unrealized foreign currency translation loss in the third quarter of 2006 is primarily driven by the decline in the functional currency on our investment in Vodafone Omnitel N.V. (Vodafone Omnitel). The unrealized foreign currency translation gain in the nine months ended September 30, 2006 is primarily driven by the appreciation in the functional currency on our investment in Vodafone Omnitel. The unrealized foreign currency translation loss in 2005 was primarily driven by a decline in the functional currencies on our investments in Vodafone Omnitel and Verizon Dominicana.

During the third quarter of 2005, we entered into interest rate derivatives to limit our exposure to interest rate changes. In accordance with the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133), and related amendments and interpretations, changes in fair value of these cash flow hedges due to interest rate fluctuations were recognized in Accumulated Other Comprehensive Loss. Also, during the second and third quarters of 2005, we entered into zero cost euro collars to hedge a portion of our net investment in Vodafone Omnitel. In accordance with the provisions of SFAS No. 133, changes in the fair value of these contracts due to exchange rate fluctuations are recognized in Accumulated Other Comprehensive Loss and offset the impact of foreign currency changes on the value of our net investment in the operation being hedged. As of September 30, 2006, our positions in the interest rate derivatives and the zero cost euro collars have been settled.

The components of Accumulated Other Comprehensive Loss are as follows:

| (Dollars in Millions) | At September 30, 2006 | At December 31, 2005 |
|--|-----------------------|----------------------|
| Foreign currency translation adjustments | \$ (657) | \$ (867) |
| Unrealized gains on net investment hedges | 2 | 2 |
| Unrealized derivative losses on cash flow hedges | (14) | (27) |
| Unrealized gains on marketable securities | 41 | 10 |
| Minimum pension liability adjustment | (888) | (901) |
| Accumulated other comprehensive loss | \$ (1,516) | \$ (1,783) |

Table of Contents**9. 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) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|----------|---------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Net Income Used For Basic Earnings Per Common Share | | | | |
| Income before discontinued operations and cumulative effect of accounting change | \$ 1,798 | \$ 1,792 | \$ 4,826 | \$ 5,547 |
| Income from discontinued operations, net of tax | 124 | 77 | 381 | 192 |
| Cumulative effect of accounting change, net of tax | | | (42) | |
| Net income | \$ 1,922 | \$ 1,869 | \$ 5,165 | \$ 5,739 |
| Net Income Used For Diluted Earnings Per Common Share | | | | |
| Income before discontinued operations and cumulative effect of accounting change | \$ 1,798 | \$ 1,792 | \$ 4,826 | \$ 5,547 |
| After-tax minority interest expense related to exchangeable equity interest | 4 | 9 | 20 | 23 |
| After-tax interest expense related to zero-coupon convertible notes | | 6 | 11 | 20 |
| Income before discontinued operations and cumulative effect of accounting change after assumed conversion of dilutive securities | 1,802 | 1,807 | 4,857 | 5,590 |
| Income from discontinued operations, net of tax | 124 | 77 | 381 | 192 |
| Cumulative effect of accounting change, net of tax | | | (42) | |
| Net income after assumed conversion of dilutive securities | \$ 1,926 | \$ 1,884 | \$ 5,196 | \$ 5,782 |
| Basic Earnings Per Common Share⁽¹⁾ | | | | |
| Weighted-average shares outstanding basic | 2,907 | 2,765 | 2,911 | 2,767 |
| Income before discontinued operations and cumulative effect of accounting change | \$.62 | \$.65 | \$ 1.66 | \$ 2.00 |
| Income from discontinued operations, net of tax | .04 | .03 | .13 | .07 |
| Cumulative effect of accounting change, net of tax | | | (.01) | |
| Net income | \$.66 | \$.68 | \$ 1.77 | \$ 2.07 |
| Diluted Earnings Per Common Share⁽¹⁾ | | | | |
| Weighted-average shares outstanding basic | 2,907 | 2,765 | 2,911 | 2,767 |
| Effect of dilutive securities: | | | | |
| Stock options | 1 | 6 | 1 | 5 |
| Exchangeable equity interest | 15 | 29 | 25 | 29 |
| Zero-coupon convertible notes | | 17 | 8 | 17 |
| Weighted-average shares outstanding diluted | 2,923 | 2,817 | 2,945 | 2,818 |
| Income before discontinued operations and cumulative effect of accounting change | \$.62 | \$.64 | \$ 1.65 | \$ 1.98 |
| Income from discontinued operations, net of tax | .04 | .03 | .13 | .07 |
| Cumulative effect of accounting change, net of tax | | | (.01) | |
| Net income | \$.66 | \$.67 | \$ 1.76 | \$ 2.05 |

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

Stock options for 227 million shares and 233 million shares for the three and nine months ended September 30, 2006, respectively 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. For the three and nine months ended September 30, 2005, the number of shares not included in the computation of diluted earnings per share were 247 million and 246 million, respectively.

The zero coupon convertible notes were retired on May 15, 2006.

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The exchangeable equity interest was converted on August 15, 2006 by issuing 29.5 million Verizon shares (see Note 2, Acquisitions - Other Acquisitions).

10. Segment Information

As a result of reaching definitive agreements to sell our interests in Verizon Dominicana, TELPRI and CANTV, which were included in the International segment, the operations of Verizon Dominicana and TELPRI are reported as discontinued operations and assets held for sale, while CANTV continues to be accounted for as an equity method investment. Accordingly, we now have three reportable segments, which we operate and manage as strategic business units and organize by products and services. Our segments include: Wireline - including the operations of the former MCI, consists of Verizon Telecom, a provider of telephone services, including voice, broadband, data, network access, long distance, video, and other services to consumer and small business customers and carriers and Verizon Business, which provides a broad range of telecommunications and next-generation IP network services globally to medium and large businesses and government customers; Domestic Wireless - primarily representing the operations of the Verizon Wireless joint venture with Vodafone Group Plc (Vodafone), that provides domestic wireless products and services, including wireless voice and data services and equipment sales across the United States; and Information Services - representing our directory publishing businesses and electronic commerce services.

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 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.

The following table provides operating financial information for our three reportable segments and a reconciliation of segment results to consolidated results. Prior period amounts are revised to reflect the change in reportable segments as discussed above.

| (Dollars in Millions) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------------|----------------------------------|-----------|---------------------------------|-----------|
| | 2006 | 2005 | 2006 | 2005 |
| External Operating Revenues | | | | |
| Wireline | \$ 12,477 | \$ 9,183 | \$ 37,221 | \$ 27,521 |
| Domestic Wireless | 9,835 | 8,332 | 27,858 | 23,556 |
| Information Services | 804 | 857 | 2,443 | 2,608 |
| Total segments | 23,116 | 18,372 | 67,522 | 53,685 |
| Reconciling items | 138 | 114 | 468 | 536 |
| Total consolidated - reported | \$ 23,254 | \$ 18,486 | \$ 67,990 | \$ 54,221 |
| Intersegment Revenues | | | | |
| Wireline | \$ 320 | \$ 262 | \$ 840 | \$ 736 |
| Domestic Wireless | 34 | 19 | 86 | 59 |
| Information Services | | | | |
| Total segments | 354 | 281 | 926 | 795 |
| Reconciling items | (354) | (281) | (926) | (795) |
| Total consolidated - reported | \$ | \$ | \$ | \$ |
| Total Operating Revenues | | | | |
| Wireline | \$ 12,797 | \$ 9,445 | \$ 38,061 | \$ 28,257 |
| Domestic Wireless | 9,869 | 8,351 | 27,944 | 23,615 |
| Information Services | 804 | 857 | 2,443 | 2,608 |
| Total segments | 23,470 | 18,653 | 68,448 | 54,480 |

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| | | | | | |
|-----------------------------|--|-----------|-----------|-----------|-----------|
| Reconciling items | | (216) | (167) | (458) | (259) |
| Total consolidated reported | | \$ 23,254 | \$ 18,486 | \$ 67,990 | \$ 54,221 |
| Operating Income | | | | | |
| Wireline | | \$ 1,123 | \$ 1,300 | \$ 3,429 | \$ 3,754 |
| Domestic Wireless | | 2,587 | 1,819 | 7,076 | 5,141 |
| Information Services | | 373 | 441 | 1,144 | 1,269 |
| Total segments | | 4,083 | 3,560 | 11,649 | 10,164 |
| Reconciling items | | (159) | (63) | (542) | 596 |
| Total consolidated reported | | \$ 3,924 | \$ 3,497 | \$ 11,107 | \$ 10,760 |

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| (Dollars in Millions) | Three Months Ended September 30, 2006 | | Three Months Ended September 30, 2005 | |
|---|---------------------------------------|-----------------|---------------------------------------|-----------------|
| | 2006 | 2005 | 2006 | 2005 |
| Segment Income | | | | |
| Wireline | \$ 393 | \$ 537 | \$ 1,200 | \$ 1,500 |
| Domestic Wireless | 804 | 574 | 2,164 | 1,524 |
| Information Services | 249 | 279 | 728 | 798 |
| Total segment income | 1,446 | 1,390 | 4,092 | 3,822 |
| Reconciling items | 476 | 479 | 1,073 | 1,917 |
| Total consolidated net income reported | \$ 1,922 | \$ 1,869 | \$ 5,165 | \$ 5,739 |

| (Dollars in Millions) | At September 30, 2006 | At December 31, 2005 |
|---------------------------|-----------------------|----------------------|
| Assets | | |
| Wireline | \$ 90,519 | \$ 75,188 |
| Domestic Wireless | 79,094 | 76,729 |
| Information Services | 1,505 | 1,525 |
| Total segments | 171,118 | 153,442 |
| Reconciling items | 14,561 | 14,688 |
| Total consolidated | \$ 185,679 | \$ 168,130 |

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

| (Dollars in Millions) | Three Months Ended September 30, 2006 | | Three Months Ended September 30, 2005 | |
|---|---------------------------------------|----------|---------------------------------------|----------|
| | 2006 | 2005 | 2006 | 2005 |
| Total Operating Revenues | | | | |
| Hawaii operations | \$ | \$ | \$ | \$ 202 |
| Corporate, eliminations and other | (216) | (167) | (458) | (461) |
| | \$ (216) | \$ (167) | \$ (458) | \$ (259) |
| Operating Income | | | | |
| Severance, pension and benefit charges (see Note 4) | \$ (29) | \$ | \$ (329) | \$ |
| Verizon Center relocation costs (see Note 4) | (48) | 64 | (138) | 64 |
| Merger integration costs (see Note 4) | (25) | | (157) | |
| Hawaii operations | | | | 78 |
| Sales of businesses, net (see Note 5) | | | | 530 |
| Other special items (see Note 4) | | (125) | | (125) |
| Corporate and other | (57) | (2) | 82 | 49 |
| | \$ (159) | \$ (63) | \$ (542) | \$ 596 |
| Net Income | | | | |
| Debt extinguishment costs (see Note 7) | \$ | \$ (6) | \$ (16) | \$ (6) |
| Severance, pension and benefit charges (see Note 4) | (17) | | (203) | |
| Verizon Center relocation costs (see Note 4) | (31) | 37 | (88) | 37 |
| Merger integration costs (see Note 4) | (16) | | (99) | |
| Cumulative effect of accounting change (see Note 3) | | | (42) | |
| Sales of businesses, net (see Note 5) | | | | 336 |

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| | | | | |
|--|-----|--------|--------|----------|
| Tax benefits (see Note 4) | | 94 | | 336 |
| Tax benefit (provision) on repatriated earnings (see Note 4) | | 21 | | (211) |
| Other special items (see Note 4) | | (125) | | (125) |
| Income from discontinued operations, net of tax (see Note 5) | 124 | 77 | 381 | 192 |
| Corporate and other | 416 | 381 | 1,140 | 1,358 |
| | | \$ 476 | \$ 479 | \$ 1,073 |
| | | | | \$ 1,917 |

Financial information for Wireline and Information Services excludes the effects of Hawaii access lines and directory operations sold in the second quarter of 2005.

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

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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.

11. Employee Benefits

We maintain noncontributory defined benefit pension plans for the majority of our 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.

In December 2005, we announced that Verizon management employees will no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after receiving an 18-month enhancement of the value of their pension and retiree medical subsidy. In addition, new management employees hired after December 31, 2005, are not eligible for pension benefits and managers with less than 13.5 years of service as of June 30, 2006, are not eligible for company-subsidized retiree healthcare or retiree life insurance benefits. Beginning July 1, 2006, management employees receive an increased company match on their savings plan contributions.

Net Periodic Cost

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

| | (Dollars in Millions) | | | |
|------------------------------------|-----------------------|-------------|-----------------------------|-------------|
| | Pension | | Health Care and Life | |
| Three Months Ended September 30, | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 116 | \$ 173 | \$ 90 | \$ 91 |
| Interest cost | 508 | 498 | 380 | 372 |
| Expected return on plan assets | (803) | (817) | (83) | (88) |
| Amortization of prior service cost | 12 | 10 | 91 | 74 |
| Actuarial loss, net | 46 | 32 | 74 | 67 |
| Net periodic benefit (income) cost | (121) | (104) | 552 | 516 |
| Termination benefits | | 3 | | 1 |
| Settlement loss | 29 | | | |
| Total (income) cost | \$ (92) | \$ (101) | \$ 552 | \$ 517 |

| | (Dollars in Millions) | | | |
|---|-----------------------|-------------|-----------------------------|-------------|
| | Pension | | Health Care and Life | |
| Nine Months Ended September 30, | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 480 | \$ 524 | \$ 272 | \$ 273 |
| Interest cost | 1,525 | 1,498 | 1,140 | 1,114 |
| Expected return on plan assets | (2,409) | (2,456) | (249) | (264) |
| Amortization of prior service cost | 34 | 31 | 271 | 218 |
| Actuarial loss, net | 136 | 94 | 222 | 195 |
| Net periodic benefit (income) cost | (234) | (309) | 1,656 | 1,536 |
| Termination benefits | 38 | 3 | 11 | 1 |
| Termination benefits - Hawaii operations sold | | 8 | | |
| Settlement loss - Hawaii operations sold | | 80 | | |
| Curtailment loss - Hawaii operations sold | | 6 | | |
| Settlement loss | 29 | | | |

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| | | | | |
|---------------------|----------|----------|----------|----------|
| Total (income) cost | \$ (167) | \$ (212) | \$ 1,667 | \$ 1,537 |
|---------------------|----------|----------|----------|----------|

The termination benefits, settlement loss and curtailment loss amounts pertaining to the Hawaii operations sold were recorded in Sales of Businesses, Net.

Employer Contributions

In 2006, based on the funded status of the plans at December 31, 2005, we anticipate contributions of \$1 million to our qualified pension trust, \$144 million to our nonqualified pension plans and \$1,154 million to our other postretirement benefit plans. During the three months ended September 30, 2006, we made no contributions to our qualified pension trusts, and contributed \$24 million to our nonqualified pension plans and \$289 million to our other postretirement benefit plans. During the nine months ended September 30, 2006, we made no contributions to our qualified pension trusts, and contributed \$94 million to our nonqualified pension plans and \$958 million to our other

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postretirement benefit plans. Our estimate of the amount and timing of required qualified pension trust contributions for 2006 is based on current regulations, including continued pension funding relief. The anticipated required qualified pension trust contributions disclosed in Verizon's Annual Report on Form 10-K for the year ended December 31, 2005 continue to be accurate.

Severance Benefits

During the three and nine months ended September 30, 2006, we paid severance benefits of \$154 million and \$308 million, respectively. At September 30, 2006, we had a remaining severance liability of \$711 million, which includes future contractual payments to employees separated, or to be separated within 12 months, as of September 30, 2006.

12. Guarantees of Operating Subsidiary Debt

Verizon has guaranteed the obligations of the following two 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 September 30, 2006**

| (Dollars in Millions) | Verizon New | | Verizon South | Other | Adjustments | Total |
|--|-------------|---------|------------------|-----------|-------------|-----------|
| | Parent | England | | | | |
| Operating revenues | \$ | \$ 957 | \$ 212 | \$ 22,284 | \$ (199) | \$ 23,254 |
| Operating expenses | 39 | 960 | 171 | 18,359 | (199) | 19,330 |
| Operating income (loss) | (39) | (3) | 41 | 3,925 | | 3,924 |
| Equity in earnings of unconsolidated businesses | 1,836 | 3 | | (99) | (1,452) | 288 |
| Other income and (expense), net | 391 | 5 | 1 | 94 | (390) | 101 |
| Interest expense | (331) | (43) | (12) | (192) | 6 | (572) |
| Minority interest | | | | (1,088) | | (1,088) |
| Income (loss) before provision for income taxes and discontinued operations | 1,857 | (38) | 30 | 2,640 | (1,836) | 2,653 |
| Income tax benefit (provision) | 65 | 19 | (11) | (928) | | (855) |
| Income (loss) before discontinued operations | 1,922 | (19) | 19 | 1,712 | (1,836) | 1,798 |
| Income from discontinued operations, net of tax | | | | 124 | | 124 |
| Net income (loss) | \$ 1,922 | \$ (19) | \$ 19 | \$ 1,836 | \$ (1,836) | \$ 1,922 |

Table of Contents**Condensed Consolidating Statements of Income****Nine Months Ended September 30, 2006**

| (Dollars in Millions) | Verizon New | | | | Adjustments | Total |
|---|-------------|----------|---------------|-----------|-------------|-----------|
| | Parent | England | Verizon South | Other | | |
| Operating revenues | \$ | \$ 2,908 | \$ 640 | \$ 65,015 | \$ (573) | \$ 67,990 |
| Operating expenses | 131 | 2,766 | 491 | 54,068 | (573) | 56,883 |
| Operating income (loss) | (131) | 142 | 149 | 10,947 | | 11,107 |
| Equity in earnings of unconsolidated businesses | 4,969 | 10 | | (444) | (3,919) | 616 |
| Other income and (expense), net | 1,122 | 9 | 14 | 189 | (1,070) | 264 |
| Interest expense | (883) | (134) | (43) | (758) | 20 | (1,798) |
| Minority interest | | | | (2,942) | | (2,942) |
| Income before provision for income taxes, discontinued operations and cumulative effect of accounting change | 5,077 | 27 | 120 | 6,992 | (4,969) | 7,247 |
| Income tax benefit (provision) | 88 | (1) | (45) | (2,463) | | (2,421) |
| Income before discontinued operations and cumulative effect of accounting change | 5,165 | 26 | 75 | 4,529 | (4,969) | 4,826 |
| Income from discontinued operations, net of tax | | | | 381 | | 381 |
| Cumulative effect of accounting change, net of tax | | | | (42) | | (42) |
| Net income | \$ 5,165 | \$ 26 | \$ 75 | \$ 4,868 | \$ (4,969) | \$ 5,165 |

Condensed Consolidating Statements of Income**Three Months Ended September 30, 2005**

| (Dollars in Millions) | Verizon New | | | | Adjustments | Total |
|---|-------------|---------|---------------|-----------|-------------|-----------|
| | Parent | England | Verizon South | Other | | |
| Operating revenues | \$ | \$ 993 | \$ 227 | \$ 17,386 | \$ (120) | \$ 18,486 |
| Operating expenses | 32 | 924 | 174 | 13,979 | (120) | 14,989 |
| Operating income (loss) | (32) | 69 | 53 | 3,407 | | 3,497 |
| Equity in earnings of unconsolidated businesses | 1,747 | 3 | | 88 | (1,656) | 182 |
| Other income and (expense), net | 137 | (8) | 2 | 53 | (96) | 88 |
| Interest expense | (21) | (43) | (16) | (450) | 5 | (525) |
| Minority interest | | | | (748) | | (748) |
| Income before provision for income taxes and discontinued operations | 1,831 | 21 | 39 | 2,350 | (1,747) | 2,494 |
| Income tax benefit (provision) | 38 | (5) | (15) | (720) | | (702) |

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| | | | | | | |
|---|----------|-------|-------|----------|------------|----------|
| Income before discontinued operations | 1,869 | 16 | 24 | 1,630 | (1,747) | 1,792 |
| Income from discontinued operations, net of tax | | | | 77 | | 77 |
| Net income | \$ 1,869 | \$ 16 | \$ 24 | \$ 1,707 | \$ (1,747) | \$ 1,869 |

Table of Contents**Condensed Consolidating Statements of Income****Nine Months Ended September 30, 2005**

| (Dollars in Millions) | Verizon New | | | | Adjustments | Total |
|---|-------------|----------|---------------|-----------|-------------|-----------|
| | Parent | England | Verizon South | Other | | |
| Operating revenues | \$ | \$ 2,945 | \$ 683 | \$ 50,934 | \$ (341) | \$ 54,221 |
| Operating expenses | 30 | 2,682 | 512 | 40,578 | (341) | 43,461 |
| Operating income (loss) | (30) | 263 | 171 | 10,356 | | 10,760 |
| Equity in earnings of unconsolidated businesses | 5,233 | 18 | | 244 | (4,942) | 553 |
| Other income and (expense), net | 372 | (6) | 4 | 223 | (303) | 290 |
| Interest expense | (39) | (128) | (48) | (1,398) | 12 | (1,601) |
| Minority interest | | | | (2,069) | | (2,069) |
| Income before provision for income taxes and discontinued operations | 5,536 | 147 | 127 | 7,356 | (5,233) | 7,933 |
| Income tax benefit (provision) | 203 | (45) | (49) | (2,495) | | (2,386) |
| Income before discontinued operations | 5,739 | 102 | 78 | 4,861 | (5,233) | 5,547 |
| Income from discontinued operations, net of tax | | | | 192 | | 192 |
| Net income | \$ 5,739 | \$ 102 | \$ 78 | \$ 5,053 | \$ (5,233) | \$ 5,739 |

Condensed Consolidating Balance Sheets**At September 30, 2006**

| (Dollars in Millions) | Verizon New | | | | Adjustments | Total |
|--|-------------|----------|---------------|------------|-------------|------------|
| | Parent | England | Verizon South | Other | | |
| Cash | \$ | \$ | \$ | \$ 1,846 | \$ | \$ 1,846 |
| Short-term investments | | 71 | 11 | 1,507 | | 1,589 |
| Accounts receivable, net | 10 | 706 | 114 | 10,836 | (832) | 10,834 |
| Other current assets | 27,021 | 150 | 29 | 7,157 | (27,011) | 7,346 |
| Total current assets | 27,031 | 927 | 154 | 21,346 | (27,843) | 21,615 |
| Plant, property and equipment, net | 1 | 6,148 | 1,137 | 74,116 | | 81,402 |
| Investments in unconsolidated businesses | 42,938 | 116 | | 6,129 | (44,705) | 4,478 |
| Other assets | 621 | 429 | 388 | 76,976 | (230) | 78,184 |
| Total assets | \$ 70,591 | \$ 7,620 | \$ 1,679 | \$ 178,567 | \$ (72,778) | \$ 185,679 |
| Debt maturing within one year | \$ 8,041 | \$ 186 | \$ 273 | \$ 30,144 | \$ (27,115) | \$ 11,529 |

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| | | | | | | |
|---|------------------|-----------------|-----------------|-------------------|--------------------|-------------------|
| Other current liabilities | 2,803 | 993 | 167 | 20,549 | (728) | 23,784 |
| Total current liabilities | 10,844 | 1,179 | 440 | 50,693 | (27,843) | 35,313 |
| Long-term debt | 12,916 | 2,575 | 417 | 14,476 | (230) | 30,154 |
| Employee benefit obligations | 392 | 2,070 | 254 | 17,515 | | 20,231 |
| Deferred income taxes | 153 | 444 | 208 | 21,100 | | 21,905 |
| Other liabilities | 7 | 114 | 24 | 4,129 | | 4,274 |
| Minority interest | | | | 27,523 | | 27,523 |
| Total shareowners investment | 46,279 | 1,238 | 336 | 43,131 | (44,705) | 46,279 |
| Total liabilities and shareowners investment | \$ 70,591 | \$ 7,620 | \$ 1,679 | \$ 178,567 | \$ (72,778) | \$ 185,679 |

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

| (Dollars in Millions) | Parent | Verizon New England | Verizon South | Other | Adjustments | Total |
|---|------------------|------------------------|------------------|-------------------|--------------------|-------------------|
| Cash | \$ | \$ | \$ | \$ 776 | \$ | \$ 776 |
| Short-term investments | | 216 | 32 | 2,250 | | 2,498 |
| Accounts receivable, net | 20 | 910 | 142 | 9,042 | (1,330) | 8,784 |
| Other current assets | 9,365 | 166 | 185 | 6,999 | (9,497) | 7,218 |
| Total current assets | 9,385 | 1,292 | 359 | 19,067 | (10,827) | 19,276 |
| Plant, property and equipment, net | 1 | 6,146 | 1,158 | 65,848 | | 73,153 |
| Investments in unconsolidated businesses | 32,593 | 116 | | 10,017 | (38,122) | 4,604 |
| Other assets | 532 | 472 | 390 | 69,933 | (230) | 71,097 |
| Total assets | \$ 42,511 | \$ 8,026 | \$ 1,907 | \$ 164,865 | \$ (49,179) | \$ 168,130 |
| Debt maturing within one year | \$ 22 | \$ 471 | \$ | \$ 15,999 | \$ (9,804) | \$ 6,688 |
| Other current liabilities | 2,511 | 1,049 | 176 | 16,769 | (1,023) | 19,482 |
| Total current liabilities | 2,533 | 1,520 | 176 | 32,768 | (10,827) | 26,170 |
| Long-term debt | 92 | 2,702 | 901 | 28,104 | (230) | 31,569 |
| Employee benefit obligations | 205 | 1,892 | 254 | 15,847 | | 18,198 |
| Deferred income taxes | | 537 | 220 | 21,958 | | 22,715 |
| Other liabilities | 1 | 146 | 27 | 3,189 | | 3,363 |
| Minority interest | | | | 26,435 | | 26,435 |
| Total shareowners investment | 39,680 | 1,229 | 329 | 36,564 | (38,122) | 39,680 |
| Total liabilities and shareowners investment | \$ 42,511 | \$ 8,026 | \$ 1,907 | \$ 164,865 | \$ (49,179) | \$ 168,130 |

Condensed Consolidating Statements of Cash Flows**Nine Months Ended September 30, 2006**

| (Dollars in Millions) | Parent | Verizon New England | Verizon South | Other | Adjustments | Total |
|------------------------------------|-----------|------------------------|------------------|-----------------|-------------|-----------------|
| Net cash from operating activities | \$ 2,733 | \$ 965 | \$ 202 | \$ 16,710 | \$ (2,359) | \$ 18,251 |
| Net cash from investing activities | (779) | (526) | 68 | (8,155) | 70 | (9,322) |
| Net cash from financing activities | (1,954) | (439) | (270) | (7,485) | 2,289 | (7,859) |
| Net increase in cash | \$ | \$ | \$ | \$ 1,070 | \$ | \$ 1,070 |

Condensed Consolidating Statements of Cash Flows

Nine Months Ended September 30, 2005

| (Dollars in Millions) | Parent | Verizon New England | Verizon South | Other | Adjustments | Total |
|------------------------------------|----------|------------------------|------------------|------------|-------------|------------|
| Net cash from operating activities | \$ 4,532 | \$ 537 | \$ 212 | \$ 14,098 | \$ (4,104) | \$ 15,275 |
| Net cash from investing activities | (1,121) | (413) | (167) | (11,820) | (104) | (13,625) |
| Net cash from financing activities | (3,411) | (124) | (45) | (3,952) | 4,208 | (3,324) |
| Net decrease in cash | \$ | \$ | \$ | \$ (1,674) | \$ | \$ (1,674) |

13. Recent Accounting Pronouncements*Uncertainty in Income Taxes*

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. We are required to adopt FIN 48 effective January 1, 2007. The cumulative effect of initially adopting FIN 48 will be recorded as an adjustment to opening retained earnings in the year of adoption and will be presented separately. Only tax positions that meet the more likely than not recognition threshold at the effective date may be

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recognized upon adoption of FIN 48. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

Leveraged Leases

In July 2006, the FASB issued Staff Position No. FAS 13-2, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction* (FSP 13-2). FSP 13-2 requires that changes in the projected timing of income tax cash flows generated by a leveraged lease transaction be recognized as a gain or loss in the year in which change occurs. The pretax gain or loss is required to be included in the same line item in which the leveraged lease income is recognized, with the tax effect being included in the provision for income taxes. We are required to adopt FSP 13-2 effective January 1, 2007. The cumulative effect of initially adopting this FSP will be recorded as an adjustment to opening retained earnings in the year of adoption and will be presented separately. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

Effects of Prior Year Misstatements

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 requires the quantification of financial statement errors based on the effects on the current year income statement and the cumulative effects on the balance sheet. SAB 108 is effective December 31, 2006 and we expect that the adoption of SAB 108 will not affect our results of operations or financial position.

Fair Value Measurements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurement* (SFAS No. 157). SFAS No. 157 expands disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. We are required to adopt SFAS No. 157 effective January 1, 2008 on a prospective basis. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). SFAS No. 158 requires the recognition of a defined benefit postretirement plan's funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of other accumulated comprehensive income, net of applicable income taxes. Additionally, the fair value of plan assets must be determined as of the company's year-end. We are required to adopt SFAS No. 158 effective December 31, 2006. We expect that the impact of adopting SFAS No. 158 will result in a net decrease to shareowners' investment of approximately \$10 billion. However, the impact of adopting SFAS No. 158 is dependent on plan asset performance through the end of 2006, as well as interest rates and other factors that will be applicable as of December 31, 2006.

14. 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 commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. As a result, an additional environmental remediation expense of \$240 million was recorded in Selling, General and Administrative Expense in the consolidated statements of income in 2003, for remedial activities likely to take place

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over the next several years. In September 2005, the Army Corps of Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remaining remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for some or all of the remaining remedial work at the Hicksville site, an adjustment to the remaining reserve may be necessary. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the other sites requiring remediation.

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, and no trial date has been set.

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 had the right to require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times (put windows) at its then fair market value, not to exceed \$10 billion in any one put window. In the event Vodafone exercised its put rights, we (instead of Verizon Wireless) had the right, exercisable at our sole discretion, to purchase up to \$12.5 billion of Vodafone's interest 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 which opened on June 10 and closed on August 9 in 2006, and did not exercise that right. As a result, Vodafone only has the right to require the purchase of up to \$10 billion worth of its interest, during a 61-day period opening on June 10 and closing on August 9 in 2007, under its one remaining put window. 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.

15. Subsequent Event

Spectrum Purchase

On July 7, 2006, the FCC accepted an application that Verizon Wireless filed in June 2006 seeking to qualify to bid on any of the licenses being sold in the Advanced Wireless Services spectrum auction (AWS auction) that commenced on August 9, 2006. On July 17, 2006, Verizon Wireless paid to the FCC a \$383 million deposit, which is included in Other Assets in the accompanying condensed consolidated balance sheets, in order to obtain 256 million bidding eligibility units for participation in the AWS auction. On September 18, 2006 the FCC completed the AWS auction and Verizon Wireless was the high bidder on thirteen 20 MHz licenses with bids totaling \$2,809 million. An additional \$178 million was remitted to the FCC on October 4, 2006. The remaining balance was paid to the FCC on October 19, 2006 and we expect the FCC will grant the licenses in the fourth quarter of 2006 or in the first quarter of 2007.

Disposition of Information Services

In December 2005, we announced that we were reviewing strategic alternatives for the disposition of Information Services. On July 7, 2006 we filed a Form 10 registration statement with the SEC for Verizon Directories Disposition Corporation (VDDC) in a step toward a proposed spin-off of Information Services' domestic print and Internet yellow pages directories to our stockholders. On October 18, 2006 the Verizon Board of Directors approved the proposed spin-off of our U.S. print and Internet yellow pages directories business to our shareholders. The spin-off will result in a new public company, named Idearc Inc., formerly VDDC (Idearc), that will be separate from Verizon. Subject to the satisfaction of certain conditions, the distribution is expected to occur on or about November 17, 2006 and is expected to qualify as a tax-free distribution to our shareholders.

It is expected that the spin-off will result in each shareowner receiving one share of Idearc stock for 20 shares of Verizon for shareowners of record as of November 1, 2006. As a result of the spin-off transaction, Verizon expects to reduce its debt by approximately \$7 billion through a debt-for-debt exchange mechanism and receive approximately \$2 billion in cash. We also expect that the spin-off transaction will result in an after tax charge of \$100 million to \$125 million to our consolidated results, primarily related to costs associated with the transaction. The U.S. print and Internet yellow pages directories results of operations, financial position and cash flows remain in continuing operations in our financial statements until the completion of the spin-off at which time the business will be reported as discontinued operations.

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

Overview

Verizon Communications Inc. (Verizon) is one of the world's leading providers of communications services. Verizon's Wireline telecommunications business provides local telephone services, including broadband, nationwide long-distance and other communications products and services. As a result of the MCI merger, which closed on January 6, 2006, we also own and operate one of the most expansive end-to-end global Internet Protocol (IP) networks providing access to over 140 countries worldwide and next-generation IP network services to medium and large businesses and government customers. Verizon's domestic wireless business, operating as Verizon Wireless, 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. Stressing diversity and commitment to the communities in which we operate, Verizon has a highly diverse workforce of 250,000 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 to higher growth markets such as wireless, long distance, wireline broadband connections, including digital subscriber lines (DSL) and fiber optics to the home (Verizon's FiOS data and TV services) and other data services, as well as expanded services to business markets, rather than to traditional wireline voice services, where we have been experiencing access line losses. In the third quarter of 2006, revenues from these growth areas were more than 50% of total revenue. Verizon reported consolidated revenue growth of 25.8% in the third quarter of 2006 compared to the similar period in 2005. This revenue growth was primarily driven by the merger with MCI, as well as higher revenue at Domestic Wireless. Verizon added 1,912,000 wireless customers and 448,000 broadband connections in the third quarter of 2006.

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 real estate consolidations and call center routing improvements, has been to significantly change the company's cost structure and maintain stable operating income margins. Real estate consolidations include our decision to establish Verizon Center for the leadership team. With our deployment of the FiOS network, we expect to realize savings in annual, ongoing operating expenses as a result of efficiencies gained from fiber network facilities. In 2005, Verizon restructured its management retirement benefit plans such that management employees no longer earn pension benefits or earn service towards the company retiree medical subsidy after June 30, 2006, after being provided an 18-month enhancement of the value of their pension and retiree medical benefits, but will receive higher savings plan matching contributions. The net effect of these management benefit plan changes is expected to be a reduction in pretax benefit expenses of approximately \$3 billion over 10 years.

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Capital Allocation Our 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 expanded services to business markets are examples of areas of capital spending in support of these growth markets. In the nine months ended September 30, 2006, capital expenditures were \$12,318 million compared to \$11,363 million in the nine months ended September 30, 2005. In 2006, Verizon management expects capital expenditures to be in the range of \$17.0 billion to \$17.4 billion. In addition to capital expenditures, Domestic Wireless continues to participate in the FCC's wireless spectrum auctions and continues to evaluate spectrum acquisitions in support of

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expanding data applications and its growing customer base. On September 18, 2006, the FCC completed the Advanced Wireless Services spectrum auction (AWS auction) and Verizon Wireless was the high bidder on thirteen 20 MHz licenses covering a population of nearly 200 million, with bids totaling \$2,809 million.

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. Verizon's total debt increased to \$41,683 million as of September 30, 2006 from \$38,257 million as of December 31, 2005, primarily as a result of debt acquired in connection with the MCI merger. However, Verizon's ratio of debt to debt combined with shareowners' equity was 47.4% as of September 30, 2006 compared with 49.1% as of December 31, 2005 and 49.7% as of September 30, 2005. Verizon repurchased \$1,348 million of its common stock as part of its previously announced program during the nine months ended September 30, 2006. Additionally, Verizon's balance of cash and cash equivalents at September 30, 2006 was \$1,846 million.

Supporting these key focus areas are continuing initiatives to effectively package and enhance the value of our products and services. In 2004, Verizon announced a deployment expansion of FiOS in several states in our service territory. As of the end of 2005, we met our goal of passing three million premises and are on target to pass a total of 6 million premises by year-end 2006. Our FiOS Internet service continues to gain market share against competitive services in a growing broadband market by offering unsurpassed Internet-access speeds, with upstream speeds of up to 10 Mbps (megabits per second) and with plans to offer downstream speeds of up to 100 Mbps. We have achieved a data penetration rate of 14% across all markets where we have been selling FiOS data, with 3.8 million premises open for sale as of the end of the third quarter of 2006. As of September 30, 2006, FiOS data services are available in 16 states. In 2005, Verizon began offering video on the FiOS network in three markets and now video service is available in 7 states and we continue our efforts to acquire franchises to offer video services. As of September 30, 2006, Verizon obtained 165 video franchises covering 3.4 million households with service available for sale to 1.2 million premises. We have set a target of 175,000 FiOS TV customers by year-end 2006, making the service available to 1.8 million households. As of the September 30, 2006, Verizon had 118,000 FiOS TV customers, which is a video service penetration rate of 10% across all markets. FiOS TV includes a collection of all-digital programming with as many as 395 channels, 47 music channels and 27 high-definition television channels. Innovative product bundles include local wireline, long distance, wireless and broadband services for consumer and general business retail customers. These efforts will also help counter the effects of competition and technology substitution that have resulted in access line losses.

Our integration activities in connection with the MCI merger are continuing on plan. During this period, we have trained our salesforce regarding the products and services available, including new products and bundled product offerings, to the customers of the Verizon Business product line. In 2006, we expect to achieve at least \$550 million of merger synergies, and incur integration expenses of approximately \$250 million. These synergies include, in part, workforce reductions and data traffic migration onto Verizon's networks rather than utilizing third party access providers.

At Domestic Wireless, we continue to execute on the fundamentals of our network superiority and value proposition to deliver growth for the business and provide new and innovative products and services for our customers such as Broadband Access, our Evolution Data Optimized (EV-DO) service. To accomplish our goal of being the acknowledged market leader in providing wireless voice and data communication services in the U.S, we will continue to implement the following key elements of our business strategy:

Provide the highest network quality through our code division multiple access (CDMA) 1XRTT technology and EV-DO technology, which significantly increases data transmission rates.

Profitably acquire, satisfy and retain our customers and increase the value of our service offerings to customers while achieving revenue and net income growth.

Continue to expand our wireless data, messaging and multi-media offerings for both consumer and business customers and take advantage of the growing demand for wireless data services.

Focus on operating margins and capital efficiency by driving down costs and leveraging our scale.

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On April 3, 2006, we reached definitive agreements to sell our interests in Verizon Dominicana, C. por A. (Verizon Dominicana), Telecomunicaciones de Puerto Rico, Inc. (TELPRI) and Compañía Anónima Nacional Teléfonos de Venezuela (CANTV) in three separate transactions to América Móvil, S.A. de C.V. (América Móvil), a wireless

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service provider throughout Latin America, and a company owned jointly by Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil.

On October 18, 2006, the Verizon Board of Directors approved the proposed spin-off of our U.S. print and Internet yellow pages directories business to our shareholders. Additional information related to this transaction is included in the Recent Developments section herein.

Consolidated Results of Operations

In this section, we discuss our overall results of operations and highlight special and non-recurring items. As a result of reaching definitive agreements to sell our interests in Verizon Dominicana, TELPRI and CANTV, which were included in the International segment, the operations of Verizon Dominicana and TELPRI are reported as discontinued operations and assets held for sale, while CANTV continues to be accounted for as an equity method investment. Accordingly, we now have three reportable segments. Prior period amounts and discussions are revised to reflect this change. We include in our results of operations the results of the former MCI business subsequent to the close of the merger on January 6, 2006. 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 September 30, | | % Change | Nine Months Ended September 30, | | % Change |
|------------------------------------|----------------------------------|------------------|-------------|---------------------------------|------------------|-------------|
| | 2006 | 2005 | | 2006 | 2005 | |
| Wireline | | | | | | |
| Verizon Telecom | \$ 8,325 | \$ 8,056 | | \$ 25,104 | \$ 24,068 | |
| Verizon Business | 5,201 | 1,852 | | 15,171 | 5,550 | |
| Intrasegment eliminations | (729) | (463) | | (2,214) | (1,361) | |
| | 12,797 | 9,445 | 35.5% | 38,061 | 28,257 | 34.7% |
| Domestic Wireless | 9,869 | 8,351 | 18.2 | 27,944 | 23,615 | 18.3 |
| Information Services | 804 | 857 | (6.2) | 2,443 | 2,608 | (6.3) |
| Corporate & Other | (216) | (167) | 29.3 | (458) | (461) | (0.7) |
| Revenues of Hawaii operations sold | | | | | 202 | (100.0) |
| Consolidated Revenues | \$ 23,254 | \$ 18,486 | 25.8 | \$ 67,990 | \$ 54,221 | 25.4 |

Consolidated revenues in the third quarter of 2006 were higher by \$4,768 million, or 25.8%, and \$13,769 million, or 25.4%, for the nine months ended September 30, 2006 compared to the similar periods in 2005. These increases were primarily the result of significantly higher revenues at Wireline and Domestic Wireless, partially offset by the sale of Hawaii operations in the second quarter of 2005.

Revenues at the Wireline segment increased during the third quarter of 2006 by \$3,352 million, or 35.5% and \$9,804 million, or 34.7% for the nine months ended September 30, 2006 compared to the similar periods in 2005. The increase is primarily attributable to the acquisition of MCI and, to a lesser extent, growth from broadband and long distance services. Broadband connections increased to 6.6 million lines at September 30, 2006, an increase of 45.1% from September 30, 2005. The number of Freedom service plans continue to stimulate growth in long distance services, as the number of packages reached 7.5 million as of September 30, 2006, representing a 48.9% increase from September 30, 2005. These increases were partially offset by declines in wholesale revenues at Verizon Telecom and continued downward pressure due to subscriber losses resulting from technology substitution, including Wireless and Voice over Internet Protocol (VoIP). Wholesale revenues at Verizon

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Telecom declined by \$180 million, or 7.9% for the third quarter of 2006 and by \$545 million, or 8.0% for the nine months ended September 30, 2006 compared to similar periods in 2005 primarily due to the exclusion of affiliated access revenues billed to the former MCI mass market entities in the current quarter and year-to-date periods. Revenues at Verizon Business increased primarily due to the acquisition of MCI.

Domestic Wireless s revenues increased during the third quarter of 2006 by \$1,518 million, or 18.2% and \$4,329 million, or 18.3% for the nine months ended September 30, 2006 compared to the similar periods in 2005 due to increases in service revenues, including data revenues, and equipment and other revenues. Data revenues were \$1,197 million in the third quarter of 2006 and \$3,104 million for the nine months ended September 30, 2006,

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compared to \$613 million and \$1,512 million in the third quarter of 2005 and the nine months ended September 30, 2005, respectively. Domestic Wireless ended the third quarter of 2006 with 56.7 million customers, an increase of 15.1% over the third quarter of 2005. Domestic Wireless' retail customer base as of September 30, 2006 was approximately 54.6 million, a 15.6% increase over the third quarter of 2005, and comprised approximately 96.2% of our total customer base. Average service revenue per customer (ARPU) increased by 0.9% to \$50.59 in the third quarter of 2006 compared to the similar period in 2005, primarily attributable to increases in data revenue per customer driven by increased use of our messaging and other data services. ARPU increased by 0.3% to \$49.68 for the nine months ended September 30, 2006 compared to the similar period in 2005. ARPU per retail customer of \$51.21 for the quarter ended September 30, 2006 also grew compared to the similar period in 2005. Increases in wireless devices sold and revenue per unit sold drove increases in equipment and other revenue in the third quarter of 2006 and for the nine months ended September 30, 2006 compared to the similar periods in 2005.

Consolidated Operating Expenses

| (Dollars in Millions) | Three Months Ended September 30, | | % Change | Nine Months Ended September 30, | | % Change |
|---|----------------------------------|------------------|-------------|---------------------------------|------------------|-------------|
| | 2006 | 2005 | | 2006 | 2005 | |
| Cost of services and sales | \$ 8,982 | \$ 6,361 | 41.2% | \$ 26,349 | \$ 18,390 | 43.3% |
| Selling, general and administrative expense | 6,720 | 5,195 | 29.4 | 19,587 | 15,382 | 27.3 |
| Depreciation and amortization expense | 3,628 | 3,433 | 5.7 | 10,947 | 10,219 | 7.1 |
| Sale of businesses, net | | | nm | | (530) | (100.0) |
| Total Operating Expenses | \$ 19,330 | \$ 14,989 | 29.0 | \$ 56,883 | \$ 43,461 | 30.9 |

nm Not meaningful

Cost of Services and Sales

Consolidated cost of services and sales in the third quarter of 2006 increased \$2,621 million, or 41.2% and \$7,959 million, or 43.3% for the nine months ended September 30, 2006 compared to the similar periods in 2005. These increases were primarily driven by higher costs attributable to the inclusion of the former MCI operations in the Wireline segment subsequent to the completion of the merger, higher wireless network costs, increases in wireless equipment costs and increases in pension and other postretirement benefit costs, partially offset by the net impact of productivity improvement initiatives.

The higher wireless network costs were caused by increased network usage relating to both voice and data services in the third quarter of 2006 and for the nine months ended September 30, 2006 compared to the similar periods in 2005, partially offset by decreased roaming, local interconnection and long distance rates. Cost of wireless equipment sales increased in the third quarter of 2006 and for the nine months ended September 30, 2006 compared to the similar periods in 2005 primarily as a result of an increase in wireless devices sold due to an increase in gross activations and equipment upgrades, together with an increase in cost per unit.

Costs in these periods were also impacted by increased pension and other postretirement benefit costs. As of December 31, 2005, we evaluated key employee benefit plan assumptions in response to current conditions in the securities markets. The overall impact of the 2006 assumptions, combined with the impact of lower than expected actual asset returns over the past several years, resulted in pension and other postretirement benefit expense of approximately \$332 million in the third quarter of 2006 and \$1,100 million for the nine months ended September 30, 2006, compared to net pension and postretirement benefit expense of \$319 million and \$954 million in the third quarter of 2005 and nine months ended September 30, 2005, respectively. Special and non-recurring items recorded during the third quarter of 2006 included \$6 million of merger integration costs.

Selling, General and Administrative Expense

Consolidated selling, general and administrative expense in the third quarter of 2006 increased \$1,525 million, or 29.4% and \$4,205 million, or 27.3% for the nine months ended September 30, 2006 compared to the similar periods in 2005. These increases were primarily attributable to the

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inclusion of the former MCI operations in the Wireline segment subsequent to the completion of the merger, increases in the Domestic Wireless segment primarily related to increased salary and benefits expenses, and special and non-recurring charges.

Special and non-recurring items recorded during the third quarter of 2006 include \$29 million related to pension settlement losses incurred in connection with our benefit plans. For the nine months ended September 30, 2006, special and non-recurring charges also included \$300 million for employee severance and severance-related activities

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in connection with the involuntary separation of approximately 3,200 employees, the majority of whom were separated in the second and third quarters of 2006. The remaining employees will be separated during the fourth quarter of 2006. Special and non-recurring charges also included \$19 million and \$151 million in the third quarter of 2006 and nine months ended September 30, 2006 respectively, of merger integration costs, primarily for advertising and other costs related to re-branding initiatives and systems integration activities. Additionally, the third quarter of 2006 and nine months ended September 30, 2006 included \$48 million and \$138 million, respectively, of special and non-recurring charges for Verizon Center relocation costs. Special and non-recurring items in the third quarter of 2005 and the nine months ended September 30, 2005 included a pretax impairment charge of \$125 million pertaining to our leasing operations for airplanes leased to airlines experiencing financial difficulties, partially offset by net pretax gain of \$64 million in connection with the relocation of several functions to Verizon Center.

Depreciation and Amortization Expense

Consolidated depreciation and amortization expense in the third quarter of 2006 increased \$195 million, or 5.7% and \$728 million, or 7.1% for the nine months ended September 30, 2006 compared to the similar periods in 2005 primarily due to higher depreciable and amortizable asset bases as a result of the MCI merger and, to a lesser extent, increased capital expenditures.

Sales of Businesses, Net

During the second quarter of 2005, we sold our wireline and directory businesses in Hawaii and recorded a pretax gain of \$530 million.

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

Equity in earnings of unconsolidated businesses increased by \$106 million, or 58.2% in the third quarter of 2006 and by \$63 million, or 11.4% for the nine months ended September 30, 2006 compared to the similar periods in 2005. The increase for the third quarter of 2006 compared to the similar period of 2005 is primarily driven by additional pension liabilities at CANTV recorded in the prior year quarter as well as higher tax benefits at CANTV and improved operational results. In addition, the increase reflects our proportionate share, or \$85 million, of a tax benefit booked at Vodafone Omnitel, partially offset by a similar benefit recorded in the three months ended September 30, 2005 of \$76 million. The increase for the nine months ended September 30, 2006 compared to the similar period of 2005 is primarily driven by the aforementioned items described above, partially offset by lower operational results, lower tax benefits and unfavorable foreign exchange fluctuations at Vodafone Omnitel compared with the similar period in 2005.

Other Income and (Expense), Net

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------------|----------------------------------|-------|----------|---------------------------------|--------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Interest income | \$ 40 | \$ 24 | 66.7% | \$ 143 | \$ 87 | 64.4% |
| Foreign exchange gains, net | 2 | 12 | (83.3) | 5 | 11 | (54.5) |
| Other, net | 59 | 52 | 13.5 | 116 | 192 | (39.6) |
| Total | \$ 101 | \$ 88 | 14.8 | \$ 264 | \$ 290 | (9.0) |

The increase in other income and expense, net in the third quarter of 2006 compared to the similar period of 2005 is primarily due to higher interest income as well as higher Other, net income, partially offset by lower foreign exchange gains. Other, net income in the third quarter of 2006 includes leased asset gains compared to leased asset losses in the similar period of 2005. Other, net income in the third quarter of 2006 also includes a pretax gain on the sale of a small domestic investment, while the third quarter of 2005 includes a pretax gain on the sale of a small international business and other investment gains. Additionally, Other, net income in the third quarter of 2005 includes costs of \$10 million recorded in connection with the early extinguishment of debt.

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The decrease in other income and expense, net for the nine months ended September 30, 2006 compared to the similar period of 2005 is primarily due to lower Other, net income, partially offset by higher interest income. Lower Other, net income in the nine months ended September 30, 2006 was primarily driven by leased asset losses

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compared to leased asset gains in the similar period of 2005, as well as by higher gains on the sales of businesses and investments in the nine months ended September 30, 2005.

Interest Expense

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---------------------------------------|----------------------------------|-----------|----------|---------------------------------|-----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Interest expense | \$ 572 | \$ 525 | 9.0% | \$ 1,798 | \$ 1,601 | 12.3% |
| Capitalized interest costs | 125 | 100 | 25.0 | 350 | 263 | 33.1 |
| Total interest costs on debt balances | \$ 697 | \$ 625 | 11.5 | \$ 2,148 | \$ 1,864 | 15.2 |
| Average debt outstanding | \$ 41,979 | \$ 39,808 | | \$ 42,441 | \$ 39,511 | |
| Effective interest rate | 6.64% | 6.28% | | 6.75% | 6.29% | |

The increase in interest costs for the third quarter of 2006 and for the nine months ended September 30, 2006 compared to the similar periods in 2005 were due to higher average debt levels of \$2,171 million and \$2,930 million, respectively, as a result of the debt acquired in connection with the merger with MCI, and higher average interest rates, partially offset by a higher level of interest capitalized in connection with the build-out of our FiOS network.

Minority Interest

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------|----------------------------------|--------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Minority interest | \$ 1,088 | \$ 748 | 45.5% | \$ 2,942 | \$ 2,069 | 42.2% |

The increase in minority interest expense in the third quarter of 2006 and for the nine months ended September 30, 2006 compared to the similar periods in 2005 is primarily due to the higher earnings at Domestic Wireless, which has a significant minority interest attributable to Vodafone Group Plc (Vodafone).

Provision for Income Taxes

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|----------------------------|----------------------------------|--------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Provision for income taxes | \$ 855 | \$ 702 | 21.8% | \$ 2,421 | \$ 2,386 | 1.5% |
| Effective income tax rate | 32.2% | 28.1% | | 33.4% | 30.1% | |

The effective income tax rate is the provision for income taxes as a percentage of income before the provision for income taxes, discontinued operations and cumulative effect of accounting change. The effective tax rate for the third quarter of 2006 compared to the similar period of 2005 was higher due to tax benefits recorded in 2005 related to prior year investment losses, the impact of favorable tax benefits resulting from tax reserve adjustments, including audit settlements and other activity in 2005 compared to 2006 and higher state taxes in 2006 due to a favorable legislative change which decreased state taxes in 2005. This increase in the 2006 rate compared to the 2005 rate was partially offset by higher foreign related tax benefits as well as by benefits provided by the American Jobs Creation Act of 2004. The effective tax rate for the nine months ended September 30, 2006 compared to the similar period of 2005 was higher as a result of those items described above, with the exception of lower state taxes benefiting the 2006 period compared to the similar period of 2005. In addition, principally as a result of the capital gain realized in the second quarter of 2005 in connection with the sale of our Hawaii businesses, we recorded tax benefits of \$336 million in 2005 primarily related to previous investment losses, which was largely offset by a net tax provision of \$211 million related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004.

Cumulative Effect of Accounting Change

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(R), *Share-Based Payment*, which revises SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense based on their fair value. Effective January 1, 2003, we adopted the fair value recognition provisions of SFAS No. 123, using the prospective

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method (as permitted under SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*) for all new awards granted, modified or settled after January 1, 2003. Under the prospective method, employee compensation expense in the first year is recognized for new awards granted, modified, or settled. The options generally vest over a term of three years, therefore the expenses related to stock-based employee compensation included in the determination of net income for 2006, 2005 and 2004 are less than what would have been recorded if the fair value method had been applied to previously issued awards.

Effective January 1, 2006, we adopted SFAS No. 123(R) utilizing the modified prospective method. SFAS No. 123(R) requires the measurement of stock-based compensation expense based on the fair value of the award on the date of grant. Under the modified prospective method, the provisions of SFAS No. 123(R) apply to all awards granted or modified after the date of adoption. SFAS No. 123(R) is supplemented by Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payments* (SAB No. 107). This SAB, which was issued by the SEC in March 2005, expresses the views of the SEC staff regarding the relationship between SFAS No. 123(R) and certain SEC rules and regulations. In particular, this SAB provides guidance related to valuation methods, the classification of compensation expense, non-GAAP financial measures, the accounting for income tax effects of share-based payment arrangements, disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS No. 123(R), and interpretations of other share-based payment arrangements. We also adopted SAB No. 107 on January 1, 2006.

We recorded a \$42 million cumulative effect of accounting change as of January 1, 2006, net of taxes and after minority interest, to recognize the effect of initially measuring the outstanding liability awards (VARs) of the Verizon Wireless joint venture at fair value utilizing a Black-Scholes model. Although we recorded a cumulative effect of adoption as of January 1, 2006, we do not expect SFAS No. 123(R) to have a material effect on our consolidated financial statements in future periods (see Note 3).

Discontinued Operations

Verizon Dominicana and Telecomunicaciones de Puerto Rico, Inc.

During the second quarter of 2006, we reached definitive agreements to sell our interests in our Caribbean and Latin American telecommunications operations in three separate transactions to América Móvil, a wireless service provider throughout Latin America, and a company owned jointly by Telmex and América Móvil. We agreed to sell our 100 percent indirect interest in Verizon Dominicana and our 52 percent interest in TELPRI to América Móvil. An entity jointly owned by América Móvil and Telmex has agreed to purchase our indirect 28.5 percent interest in CANTV.

Upon closing, the transactions are expected to result in pretax proceeds of approximately \$3,700 million, prior to purchase price adjustments as defined in the sale agreements. Each transaction is subject to separate regulatory approvals and none of the sales is contingent on the closing of any of the other transactions. We expect to close the sale of our interest in TELPRI in 2006 or 2007. In September 2006, we extended the expiration date of the Verizon Dominicana and CANTV transactions until December 29, 2006. The transactions are expected to close subject to the receipt of regulatory approvals. Although we anticipate pretax gains on the transactions, in the case of Verizon Dominicana, the U.S. taxes that will become payable and be recorded at the time the transaction closes will significantly exceed the amount of the pretax gain. In addition, the government tax authority in the Dominican Republic has issued an assessment of capital gains tax in connection with the proposed transaction. We believe that the assessment is without merit, have filed an appeal and are contesting it vigorously. We are unable to predict the ultimate outcome of this proceeding or its effect on the transaction.

Income from discontinued operations, net of tax increased by \$47 million, or 61.0% in the third quarter of 2006 and \$189 million, or 98.4% for the nine months ended September 30, 2006 compared to the similar periods in 2005. These increases were primarily due to the cessation of depreciation on fixed assets in the third quarter of 2006, consistent with the accounting requirements for discontinued operations, and the sale of directory publication rights of TELPRI, as well as the cessation of depreciation during the nine months ended September 30, 2006.

Segment Results of Operations

As a result of reaching definitive agreements to sell our interests in Verizon Dominicana, TELPRI and CANTV, which were included in the International segment, the operations of Verizon Dominicana and TELPRI are reported as discontinued operations and assets held for sale, while CANTV continues to be accounted for as an equity method investment. Accordingly, we now have three reportable segments and prior period amounts and discussions are revised to reflect this change. Our segments are Wireline, Domestic Wireless, and Information Services. You can find additional information about our segments in Note 10 to the unaudited condensed consolidated financial statements.

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We measure and evaluate our reportable segments based on segment income, which 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.

Wireline

The Wireline segment, which includes the operations of the former MCI, consists of the operations of Verizon Telecom, a provider of telephone services, including voice, broadband, data, network access, long distance, video, and other services to consumer and small business customers and carriers, and Verizon Business, a provider of next-generation IP network services globally to medium and large businesses and government customers. As discussed earlier under Consolidated Results of Operations, in the second quarter of 2005, we sold wireline properties in Hawaii representing approximately 700,000 access lines or 1% of the total Verizon Telecom switched access lines in service. For comparability purposes, the results of operations shown in the tables below exclude the Hawaii properties that have been sold.

Operating Revenues

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------------------|----------------------------------|----------|----------|---------------------------------|-----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Verizon Telecom | | | | | | |
| Mass Markets | \$ 5,640 | \$ 5,145 | 9.6% | \$ 17,014 | \$ 15,376 | 10.7% |
| Wholesale | 2,104 | 2,284 | (7.9) | 6,262 | 6,807 | (8.0) |
| Other | 581 | 627 | (7.3) | 1,828 | 1,885 | (3.0) |
| Verizon Business | | | | | | |
| Enterprise Business | 3,562 | 1,501 | 137.3 | 10,338 | 4,521 | 128.7 |
| Wholesale | 844 | 351 | 140.5 | 2,515 | 1,029 | 144.4 |
| International and Other | 795 | | nm | 2,318 | | nm |
| Intrasegment Eliminations | (729) | (463) | 57.5 | (2,214) | (1,361) | 62.7 |
| Total Wireline Operating Revenues | \$ 12,797 | \$ 9,445 | 35.5 | \$ 38,061 | \$ 28,257 | 34.7 |

nm Not meaningful

In connection with the completion of the MCI merger, our product lines were realigned to be reflective of the Line of Business structure in which the product lines are currently being managed. Prior period amounts and discussions were reclassified to conform to the current presentation.

*Verizon Telecom***Mass Markets**

Verizon Telecom's Mass Markets revenue includes local exchange (basic service and end-user access), value-added services, long distance, broadband services for residential and certain small business accounts and FiOS TV services. Value-added services are a family of services that expand the utilization of the network, including products such as Caller ID, Call Waiting, Home Voicemail and Return Call. Long distance includes both intraLATA toll services and interLATA long distance services. Broadband services include DSL and FiOS. In addition to subscriber services, Mass Markets offers non-subscriber services that include dial around long distance products.

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The increase in mass market revenue of \$495 million, or 9.6% in the third quarter of 2006 and \$1,638 million, or 10.7% for the nine months ended September 30, 2006 compared to the similar periods in 2005 was due to the inclusion of revenues from the former MCI in the current year and growth from broadband and long distance, offset by lower demand and usage of our basic local exchange and accompanying services attributable to subscriber losses due to technology substitution, including wireless and VoIP.

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We added 1,429,000 new broadband connections, including 352,000 for FiOS in the nine months ended September 30, 2006. For the third quarter 2006, we added 448,000 broadband connections, including 147,000 for FiOS, for a total of 6,573,000 lines at September 30, 2006, representing a 45.1% increase from September 30, 2005. Our Freedom service plans continue to stimulate growth in long distance services, as the number of packages reached 7.5 million as of September 30, 2006, representing a 48.9% increase from September 30, 2005. As of September 30, 2006, approximately 57% of our legacy Verizon wireline customers have chosen Verizon as their long distance carrier.

A 7.5% decline in switched access lines in service from third quarter 2005 to third quarter 2006 was mainly driven by the effects of competition and technology substitution. Demand for legacy Verizon residential access lines declined 6.8% at September 30, 2006 compared to September 30, 2005, as customers substituted wireless, broadband and cable services for traditional landline services. At the same time, legacy Verizon business access lines declined 3.2% at September 30, 2006 compared to September 30, 2005, primarily reflecting competition and a shift to high-speed, high-volume special access lines.

We continue to seek opportunities to retain and win back customers. Our Freedom service plans offer local services with various combinations of long distance and Internet access services in a discounted bundle available on one bill. We have introduced our Freedom service plans in nearly all of our key markets.

Wholesale

Wholesale revenues are earned from 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 that buy dedicated local exchange capacity to support their private networks. Wholesale services also include local wholesale revenues from unbundled network elements (UNEs), interconnection revenues from competitive local exchange carriers (CLECs) and wireless carriers, and some data transport revenues.

Wholesale revenues decreased by \$180 million, or 7.9% in the third quarter of 2006 and by \$545 million, or 8.0% for the nine months ended September 30, 2006 compared to the similar periods in 2005, due to the exclusion of affiliated access revenues billed to the former MCI mass market entities in the current quarter and year-to-date periods, and declines in legacy Verizon switched access revenues and local wholesale revenues, offset by increases in special access revenues.

Switched minutes of use (MOUs) declined in the third quarter of 2006 and for the nine months ended September 30, 2006 compared to the similar periods in 2005, reflecting the impact of access line loss and technology substitution. Wholesale lines decreased by 18.2% due to the impact of a decision by a major competitor to deemphasize their local market initiatives in 2005. 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 and services. As of September 30, 2006, customer demand for high capacity and digital data services increased 9.3% compared to the similar period in 2005.

The FCC regulates the rates that we charge customers for interstate access services. See **Other Factors That May Affect Future Results** Regulatory and Competitive Trends **FCC Regulation** for additional information on FCC rulemaking concerning federal access rates, universal service and certain broadband services.

Other

Other revenues include services such as operator services (including deaf relay services), public (coin) telephone, card services and supply sales, as well as former MCI dial around services including 10-10-987, 10-10-220, 1-800-COLLECT and Prepaid Cards.

Verizon Telecom's revenues from other services decreased by \$46 million, or 7.3% in the third quarter, and by \$57 million, or 3.0% for the nine months ended September 30, 2006 compared to the similar periods in 2005. Revenue increases, due to the inclusion of revenues from the former MCI in the current year, were more than offset by decreases due to the dissolution of non-strategic businesses, including the termination of a large commercial inventory management contract in 2005, and reduced business volumes.

Table of Contents*Verizon Business***Enterprise Business**

Our Enterprise Business market provides voice, data and internet communications services to medium and large business customers, multi-national corporations, and state and federal government customers. In addition, the Enterprise Business market also provides value-added services that make communications more secure, reliable and efficient, and managed network services for customers that outsource all or portions of their communications and information processing operations. Traditional local and long distance services comprise \$1,655 million, or 46.5% of revenue in the quarter ended September 30, 2006, and \$4,872 million or 47.1% of revenue for the nine months ended September 30, 2006. Enterprise Business also provides data services such as Private Line, Frame Relay and ATM services, both domestically and internationally, as well as managed network services to its customers.

Enterprise Business revenues increased by \$2,061 million, or 137.3% in the third quarter of 2006 and by \$5,817 million or 128.7% for the nine months ended September 30, 2006 compared to the similar periods in 2005 primarily due to the acquisition of MCI. Data services revenue represented \$1,389 million, or 39.0% of Enterprise Business's revenue stream in the third quarter of 2006 and \$4,010 million or 38.8% for the nine months ended September 30, 2006. Internet services revenue was \$518 million for the third quarter of 2006, or 14.5% of Enterprise Business's revenues and \$1,456 million or 14.1% for the nine months ended September 30, 2006. The Internet suite of products is Enterprise Business's fastest growing product line and includes Private IP, IP VPN, Web Hosting and VoIP.

Wholesale

Wholesale revenues relate to domestic wholesale services, which include all wholesale traffic sold in the United States, as well as traffic that originates in the United States and terminates in a different country.

Verizon Business wholesale revenues increased by \$493 million, or 140.5%, in the third quarter of 2006 and by \$1,486 million, or 144.4% for the nine months ended September 30, 2006 compared to the similar period in 2005, primarily due to the MCI acquisition. Local and long distance voice products, including transport, represented \$596 million or 70.6% of the market's total revenue in the third quarter of 2006, and \$1,751 million or 69.6% for the nine months ended September 30, 2006. Wholesale revenue is influenced by aggressive competitive pricing, in particular long distance voice services. Wholesale data and Internet revenues were \$248 million or 29.4% of total Wholesale revenue in the third quarter of 2006 and \$764 million or 30.4% of total Wholesale revenue for the nine months ended September 30, 2006.

International and Other

International operations serve businesses, government entities and telecommunication carriers outside of the United States. Other operations include our Skytel paging business.

Our revenues from International and Other were \$795 million in the third quarter of 2006 and \$2,318 million in the nine months ended September 30, 2006. This market represents a new revenue stream to Verizon resulting from the MCI acquisition. International and Other had voice revenue of \$472 which comprised 59.4% of the total International and Other revenues in the third quarter of 2006, and \$1,371 million or 59.1% of the total International and Other revenues for the nine months ended September 30, 2006. Internet revenues in the third quarter of 2006 represented \$228 million, or 28.7%, of total International and Other revenues and \$655 million or 28.3% of total International and Other revenues for the nine months ended September 30, 2006. Data revenues were \$95 million, or 11.9% of total International and Other revenues in the third quarter of 2006 and \$292 million or 12.6% of total International and Other revenues for the nine months ended September 30, 2006.

Operating Expenses

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|----------------------------------|----------|----------|---------------------------------|-----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Cost of services and sales | \$ 6,205 | \$ 3,932 | 57.8% | \$ 18,326 | \$ 11,633 | 57.5% |
| Selling, general and administrative expense | 3,093 | 2,016 | 53.4 | 9,142 | 6,288 | 45.4 |
| Depreciation and amortization expense | 2,376 | 2,197 | 8.1 | 7,164 | 6,582 | 8.8 |

| | | | | | |
|-----------|----------|------|-----------|-----------|------|
| \$ 11,674 | \$ 8,145 | 43.3 | \$ 34,632 | \$ 24,503 | 41.3 |
|-----------|----------|------|-----------|-----------|------|

Table of Contents*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, costs to support our outsourcing contracts and technical facilities, contributions to the universal service fund, customer provisioning costs 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.

Cost of services and sales increased by \$2,273 million, or 57.8% in the third quarter of 2006 and \$6,693 million, or 57.5% for the nine months ended September 30, 2006 compared to the similar periods in 2005. This increase was primarily due to the MCI merger partially offset by the net impact of other cost changes. Higher costs associated with our growth businesses and annual wage increases were partially offset by productivity improvement initiatives, which reduced cost of services and sales expenses in the current periods. Both periods in 2006 were also impacted by increased net pension and other postretirement benefit costs. As of December 31, 2005, we evaluated key employee benefit plan assumptions in response to current conditions in the securities markets. The overall impact of the 2006 assumptions, combined with the impact of lower than expected actual asset returns over the past several years, resulted in pension and other postretirement benefit expense of \$331 million (primarily in cost of services and sales) in the third quarter of 2006 and \$1,081 million for the nine months ended September 30, 2006, compared to net pension and postretirement benefit expense of \$312 million and \$931 million in the third quarter of 2005 and nine months ended September 30, 2005, respectively. Further, expenses decreased in both periods due to the dissolution of non-strategic businesses, including the termination of a large commercial inventory management contract in 2005.

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.

Selling, general and administrative expenses in the third quarter of 2006 increased by \$1,077 million or 53.4% and \$2,854 million or 45.4% for the nine months ended September 30, 2006 compared to the similar periods in 2005. This increase was primarily due to the inclusion of expenses from the former MCI in the current year and gains on the sale of real estate in the third quarter of 2005, partially offset by the impact of other cost changes. Additionally, there were charges related to miscellaneous adjustments at Verizon New England, partially offset by similar items at other Wireline companies. Expense reductions were attributable to cost reduction initiatives and lower bad debt costs.

Depreciation and Amortization Expense

The increase in depreciation and amortization expense of \$179 million, or 8.1% in the third quarter of 2006 and \$582 million, or 8.8% for the nine months ended September 30, 2006 compared to the similar periods in 2005 was mainly driven by the acquisition of MCI's depreciable property and equipment and finite-lived intangibles, including its customer lists and capitalized non-network software, measured at fair value and by growth in depreciable telephone plant, partially offset by lower rates of depreciation. Amortization expense increased by \$69 million in the third quarter of 2006 and \$218 million for the nine months ended September 30, 2006 compared to the similar periods in 2005, primarily due to a higher level of capitalized non-network software and amortization of the acquired MCI intangibles.

Segment Income

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------|----------------------------------|--------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Segment Income | \$ 393 | \$ 537 | (26.8)% | \$ 1,200 | \$ 1,500 | (20.0)% |

Segment income decreased by \$144 million, or 26.8% in the third quarter of 2006 and by \$300 million, or 20.0% for the nine months ended September 30, 2006 compared to the similar periods in 2005, due to the after-tax impact of operating revenues and operating expenses described above partially offset by favorable income tax adjustments.

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Special and non-recurring items not included in Verizon Wireline's segment income totaled \$44 million and \$(64) million in the third quarter of 2006 and 2005, respectively. Special and non-recurring items in the third quarter

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of 2006 included costs associated with pension settlement losses, merger integration costs as well as Verizon Center relocation-related costs. Special and non-recurring items in the third quarter of 2005 included a net gain on the sale of a New York City office building and Verizon Center relocation-related costs. Special and non-recurring items during the nine months ended September 30, 2006 of \$300 million included costs associated with severance activity, pension settlement losses, Verizon Center relocation-related costs, merger integration costs and costs associated with the redemption and refinancing of debt acquired from MCI. Special and non-recurring items totaling \$(287) million for the nine months ended September 30, 2005 related to the Hawaii results of operations and gain on the sale of the Hawaii wireline operations, the net gain on the sale of a New York City office building and Verizon Center relocation-related costs.

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 September 30, | | | Nine Months Ended September 30, | | |
|-----------------------------|----------------------------------|----------|----------|---------------------------------|-----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Wireless sales and services | \$ 9,869 | \$ 8,351 | 18.2% | \$ 27,944 | \$ 23,615 | 18.3% |

Domestic Wireless's total revenues increased by \$1,518 million, or 18.2% in the third quarter of 2006 and \$4,329 million, or 18.3% for the nine months ended September 30, 2006 compared to the similar periods in 2005. Service revenue of \$8,469 million in the third quarter of 2006 increased by \$1,199 million, or 16.5%, compared to the similar period in 2005, and service revenue of \$24,114 million for the nine months ended September 30, 2006 increased by \$3,413 million, or 16.5%, compared to the similar period in 2005. The service revenue increases were primarily due to a 15.1% increase in customers as of September 30, 2006 compared to September 30, 2005 and increases in data revenue. Equipment and other revenue increased \$319 million, or 29.5% in the third quarter of 2006 and \$916 million, or 31.4% for the nine months ended September 30, 2006 compared to the similar periods in 2005 principally as a result of increases in equipment revenue caused by increases in wireless devices sold and revenue per unit sold. Other revenue increased due to increases in revenue associated with regulatory fees, primarily the universal service fund, and cost recovery surcharges.

Our Domestic Wireless segment ended the third quarter of 2006 with approximately 56.7 million customers, compared to 49.3 million customers at the end of the third quarter of 2005. Domestic Wireless added approximately 1.9 million customers during the third quarter of 2006, unchanged compared to third quarter of 2005. We added 5.4 million net customers during the nine months ended September 30, 2006 compared to 5.5 million during the similar period in 2005. All of the net customers added during the third quarter of 2006 and substantially all of the net customers added during the nine months ended September 30, 2006 were retail customers. The overall composition of our Domestic Wireless customer base as of September 30, 2006 was 93% retail postpaid, 3% retail prepaid and 4% resellers. The average monthly churn rate, the rate at which customers disconnect service, decreased to 1.24% in the third quarter of 2006 and decreased to 1.18% for the nine months ended September 30, 2006 compared to 1.29% in the third quarter of 2005 and 1.28% for the nine months ended September 30, 2005. Retail postpaid churn decreased to 0.95% in the third quarter of 2006 and decreased to 0.92% for the nine months ended September 30, 2006, compared to 1.08% in the third quarter of 2005 and 1.07% for the nine months ended September 30, 2005.

Average service revenue per customer per month increased slightly to \$50.59 in the third quarter of 2006 and \$49.68 for the nine months ended September 30, 2006 compared to the similar periods in 2005. Average service revenue per customer included a 69% increase in data revenue per customer for the third quarter of 2006 and a 77% increase for the nine months ended September 30, 2006, compared to similar periods in 2005, driven by increased use of our messaging and other data services. However, Domestic Wireless continues to experience an increase in the proportion of customers on our family share price plans, which put downward pressure on average service revenue per customer during the three and nine months ended September 30, 2006. Data revenues of \$1,197 million, or 14.1% of service revenues in the third quarter of 2006 increased by \$584 million, or 95.3% compared to the similar period in 2005. Data revenues of \$3,104 million, or 12.9% of service revenues for

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the nine months ended September 30, 2006 increased \$1,592 million, or 105.3% compared to the similar period in 2005. Data revenue represented 8.4% and 7.3% of service revenues for the three and nine months ended September 30, 2005, respectively.

Table of Contents**Operating Expenses**

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|----------------------------------|----------|----------|---------------------------------|-----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Cost of services and sales | \$ 2,930 | \$ 2,519 | 16.3% | \$ 8,347 | \$ 6,899 | 21.0% |
| Selling, general and administrative expense | 3,132 | 2,814 | 11.3 | 8,837 | 8,051 | 9.8 |
| Depreciation and amortization expense | 1,220 | 1,199 | 1.8 | 3,684 | 3,524 | 4.5 |
| | \$ 7,282 | \$ 6,532 | 11.5 | \$ 20,868 | \$ 18,474 | 13.0 |

Cost of Services and Sales

Cost of services and sales, which are costs to operate the wireless network as well as the cost of roaming, long distance and equipment sales, grew by \$411 million, or 16.3% for the third quarter of 2006 and \$1,448 million, or 21.0% for the nine months ended September 30, 2006 compared to the similar periods in 2005. Cost of services increased due to higher wireless network costs in the current year periods caused by increased network usage relating to both voice and data services, partially offset by lower roaming, local interconnection and long distance rates. Cost of equipment sales grew by 21.9% in the third quarter of 2006 and 27.0% for the nine months ended September 30, 2006 compared to the similar periods in 2005. The increases were primarily attributed to an increase in wireless devices sold, resulting from an increase in equipment upgrades and gross retail activations, together with an increase in cost per unit, in the third quarter of 2006 and the nine months ended September 30, 2006, compared to the similar periods in 2005.

Selling, General and Administrative Expense

Selling, general and administrative expenses grew by \$318 million, or 11.3% in the third quarter of 2006 and \$786 million, or 9.8% for the nine months ended September 30, 2006 compared to the similar periods in 2005. These increases were primarily due to an increase in salary and benefits expense of \$168 million for the third quarter of 2006 and \$399 million for the nine months ended September 30, 2006, compared to the similar periods in 2005. The salary and benefits expense increase was the result of an increase in employees, primarily in the sales and customer care areas, and higher per employee salary and benefit costs. Increases in advertising and promotion expenses, as well as costs associated with regulatory fees, primarily the universal service fund, also contributed to the increases in the third quarter of 2006 and the nine months ended September 30, 2006, compared to the similar periods in 2005.

Depreciation and Amortization Expense

Depreciation and amortization increased by \$21 million, or 1.8% in the third quarter of 2006 and \$160 million, or 4.5% for the nine months ended September 30, 2006 compared to the similar periods in 2005. These increases were primarily due to increased depreciation expense related to the increase in depreciable assets.

Segment Income

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------|----------------------------------|--------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Segment Income | \$ 804 | \$ 574 | 40.1% | \$ 2,164 | \$ 1,524 | 42.0% |

Segment income increased by \$230 million, or 40.1% in the third quarter of 2006 and by \$640 million, or 42.0% for the nine months ended September 30, 2006 compared to the similar periods in 2005 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 minority interest relates to the significant minority interest attributable to Vodafone.

Information Services

Information Services multi-platform business is comprised of: print yellow pages directories; SuperPages.com, our online directory and search services; and SuperPages Mobile, our directory and information services on wireless telephones. This segment's operations are principally in the United States (see Recent Developments for information related to the approved spin-off of Information Services).

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In 2005, in connection with the sale of Verizon's wireline properties in Hawaii discussed earlier under Consolidated Results of Operations, we sold our directory operations in Hawaii. For comparability purposes, the results of operations shown in the tables below exclude the Hawaii operations that were sold.

Operating Revenues

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------|----------------------------------|--------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Operating Revenues | \$ 804 | \$ 857 | (6.2)% | \$ 2,443 | \$ 2,608 | (6.3)% |

Operating revenues decreased \$53 million, or 6.2%, in the third quarter of 2006 and \$165 million, or 6.3%, for the nine months ended September 30, 2006 compared to the similar periods in 2005. These decreases were primarily due to reduced domestic print advertising revenue and the impact of the sale of small international operations. Revenue from SuperPages.com increased 22.4% in the third quarter and 13.6% for the nine months ended September 30, 2006 compared to the similar periods in 2005.

Operating Expenses

| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|---|----------------------------------|--------|----------|---------------------------------|----------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Cost of services and sales | \$ 131 | \$ 141 | (7.1)% | \$ 420 | \$ 444 | (5.4)% |
| Selling, general and administrative expense | 278 | 252 | 10.3 | 812 | 826 | (1.7) |
| Depreciation and amortization expense | 22 | 23 | (4.3) | 67 | 69 | (2.9) |
| | \$ 431 | \$ 416 | 3.6 | \$ 1,299 | \$ 1,339 | (3.0) |

Cost of services and sales decreased in the third quarter \$10 million, or 7.1%, and \$24 million, or 5.4%, for the nine months ended September 30, 2006 compared to the similar periods in 2005. These decreases were primarily due to the sale of small international operations and decreased printing costs, partially offset by increased traffic expense associated with SuperPages.com.

Selling, general and administrative expenses in the third quarter increased \$26 million, or 10.3%, and decreased \$14 million, or 1.7%, for the nine months ended September 30, 2006. The third quarter increase is primarily due to higher sales and marketing expenses in the domestic market offset by the impact of the sale of small international operations and decreases in domestic bad debt expense. The decrease for the nine months ended September 30, 2006 is largely due to lower expenses due to the sale of international directory publishing operations and decreased bad debt expense partially offset by higher sales and marketing expenses in the domestic market.

Segment Income

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| (Dollars in Millions) | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
|-----------------------|----------------------------------|--------|----------|---------------------------------|--------|----------|
| | 2006 | 2005 | % Change | 2006 | 2005 | % Change |
| Segment Income | \$ 249 | \$ 279 | (10.8)% | \$ 728 | \$ 798 | (8.8)% |

Segment Income decreased in the third quarter \$30 million, or 10.8%, and \$70 million, or 8.8%, for the nine months ended September 30, 2006 compared to the similar periods in 2005. These decreases are primarily the result of the after-tax impact of operating revenues and operating expenses described above.

Special Items

Merger Integration Costs

During the three and the nine months ended September 30, 2006, we recorded pretax charges of \$25 million (\$16 million after-tax, or \$.01 per diluted share) and \$157 million (\$99 million after-tax, or \$.03 per diluted share), respectively, related to integration costs associated with the MCI acquisition that closed on January 6, 2006. These costs are primarily comprised of advertising and other costs related to re-branding initiatives and systems integration activities. There were no similar charges incurred during the comparable periods in 2005.

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Facility and Employee-Related Items

During the three and the nine months ended September 30, 2006, we recorded pretax charges of \$48 million (\$31 million after-tax, or \$.01 per diluted share) and \$138 million (\$88 million after-tax, or \$.03 per diluted share), respectively, in connection with the relocation of several functions to Verizon Center.

During the third quarter of 2006, we recorded net pretax pension settlement losses of \$29 million (\$17 million after-tax, or \$.01 per diluted share) related to employees that received lump-sum distributions during 2006 primarily resulting from our separation plans. These charges were 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. There were no similar items incurred during the comparable period in 2005.

During the second quarter of 2006, we recorded pretax charges of \$300 million (\$186 million after-tax, or \$.06 per diluted share), for employee severance and severance-related costs in connection with the involuntary separation of approximately 3,200 employees, the majority of whom were separated in the second and third quarters. The remaining employees will be separated during the fourth quarter of 2006.

During the third quarter of 2005, we recorded a net pretax gain of \$64 million (\$37 million after-tax, or \$.01 per diluted share) in connection with the relocation of several functions to Verizon Center, including a pretax gain of \$120 million (\$72 million after-tax, or \$.03 per diluted share) related to the sale of a New York City office building, partially offset by a pretax charge of \$56 million (\$35 million after-tax, or \$.01 per diluted share) primarily associated with relocation-related employee severance costs and related activities.

Sales of Businesses, Net

During the second quarter of 2005, we sold our wireline and directory businesses in Hawaii, including Verizon Hawaii Inc. which operates approximately 700,000 switched access lines, as well as the services and assets of Verizon Long Distance, Verizon Online, Verizon Information Services and Verizon Select Services Inc. in Hawaii, to an affiliate of The Carlyle Group for \$1,326 million in cash proceeds. In connection with this sale, we recorded a pretax gain of \$530 million (\$336 million after-tax, or \$.12 per diluted share). There were no similar items incurred during the comparable periods in 2006.

Tax Matters

During the third quarter of 2005, we recorded a tax benefit of \$94 million (\$.03 per diluted share) in connection with capital gains and prior year investment losses and a tax benefit of \$21 million (\$.01 per diluted share) related to the repatriation of prior year foreign earnings.

During the second quarter of 2005, as a result of the capital gain realized in connection with the sale of our Hawaii businesses, we recorded a tax benefit of \$242 million (\$.09 per diluted share) related to capital losses incurred in previous years.

Also during the second quarter of 2005, we recorded a net tax provision of \$232 million (\$.08 per diluted share) related to the repatriation of foreign earnings under the provisions of the American Jobs Creation Act of 2004, for two of Verizon's foreign investments. There were no similar tax matters during the comparable periods in 2006.

Other Special Items

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During the first quarter of 2006, we recorded pretax charges of \$26 million (\$16 million after-tax, or \$.01 per diluted share) resulting from the extinguishment of debt assumed in connection with the completion of the MCI merger.

During the third quarter of 2005, we recorded pretax charges of \$135 million (\$131 million after-tax, or \$.05 per diluted share) including a pretax impairment charge of \$125 million (\$125 million after-tax, or \$.04 per diluted share) pertaining to our leasing operations for aircraft leases involved in recent airline bankruptcy proceedings and a pretax charge of \$10 million (\$6 million after-tax, or less than \$.01 per diluted share) in connection with the early extinguishment of debt.

Table of Contents**Consolidated Financial Condition**

| (Dollars in Millions) | Nine months Ended September 30, | | |
|---|---------------------------------|-------------------|-----------------|
| | 2006 | 2005 | \$ Change |
| Cash Flows Provided By (Used In) | | | |
| Operating activities | \$ 18,251 | \$ 15,275 | \$ 2,976 |
| Investing activities | (9,322) | (13,625) | 4,303 |
| Financing activities | (7,859) | (3,324) | (4,535) |
| Increase (decrease) in Cash and Cash Equivalents | \$ 1,070 | \$ (1,674) | \$ 2,744 |

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 increase in cash from operating activities for the nine months ended September 30, 2006 compared to the similar period of 2005 was primarily due to lower pension contributions, higher minority interest earnings and lower dividends paid to minority partners. The nine months ended September 30, 2005 includes significant repatriations of foreign earnings of unconsolidated businesses offset by taxes paid related to foreign operations and investments sold during the fourth quarter of 2004.

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 \$7,344 million in our Wireline business during the nine months ended September 30, 2006 compared to \$6,216 million in the similar period in 2005. We also invested \$4,801 million in our Domestic Wireless business during the nine months ended September 30, 2006 compared to \$4,962 million in the similar period in 2005. The increase in capital spending at Wireline is mainly driven by the acquisition of MCI, coupled with increased spending in high growth areas such as broadband. Capital spending at Domestic Wireless represents our continuing effort to invest in this high growth business. Capital expenditures including capitalized software are expected to be \$17.0 billion to \$17.4 billion for the full year 2006.

We received net cash proceeds of \$1,037 million from acquisitions and investments in businesses during the nine months ended September 30, 2006, primarily driven by MCI's cash balances of \$2,361 million at the date of the merger, partially offset by our cash payment to MCI shareholders of \$779 million, and a \$383 million deposit to acquire broadband wireless licenses in connection with the FCC's Advanced Wireless Services spectrum auction and \$52 million to acquire other wireless properties and licenses. During the nine months ended September 30, 2005, we invested \$4,630 million in acquisitions and investments in businesses, including \$3,003 million to acquire NextWave's personal communications services licenses, \$641 million to acquire 63 broadband wireless licenses in connection with FCC auction 58, \$419 million to purchase Qwest Wireless, LLC's spectrum licenses and wireless network assets in several existing and new markets, \$230 million to purchase spectrum from MetroPCS, Inc. and \$263 million for other wireless properties and licenses. During the nine months ended September 30, 2005, we received cash proceeds of \$1,326 million in connection with the sale of Verizon's wireline and directory operations in Hawaii.

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Other, net investing activities during the nine months ended September 30, 2006 includes cash proceeds of \$335 million from leasing activities, \$256 million from property sales and \$89 million from the sale of small international investments. Other, net investing activities during the nine months ended September 30, 2005 includes \$1,121 million for the purchase of 43.4 million shares of MCI stock from eight entities affiliated with Carlos Slim Helú, offset by cash proceeds of \$680 million from property sales, including a New York City office building, \$349 million of repatriated proceeds from the sales of European investments in prior years and \$312 million from leasing activities.

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Under the terms of an investment agreement, Vodafone had the right to require Verizon Wireless to purchase up to an aggregate of \$20 billion worth of Vodafone's interest in Verizon Wireless at designated times (put windows) at its then fair market value, not to exceed \$10 billion in any one put window. In the event Vodafone exercised its put rights, we (instead of Verizon Wireless) had the right, exercisable at our sole discretion, to purchase up to \$12.5 billion of Vodafone's interest 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 which opened on June 10 and closed on August 9 in 2006, and did not exercise that right. As a result, Vodafone only has the right to require the purchase of up to \$10 billion worth of its interest, during a 61-day period opening on June 10 and closing on August 9 in 2007, under its one remaining put window. 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 \$2,917 million was used to reduce our total debt during the nine months ended September 30, 2006. We repaid \$6,838 million of Wireline debt, including premiums associated with the retirement of \$5,665 million of aggregate principal amount of long-term debt assumed in connection with the MCI merger. The Wireline repayments also included the early retirement/prepayment of \$694 million of long-term debt and \$155 million of other long-term debt at maturity. Also, we redeemed the \$1,375 million accreted principal of our remaining zero-coupon convertible notes and retired \$482 million of other corporate long-term debt at maturity. These repayments were partially offset by our issuance of long-term debt with a total aggregate principal amount of \$4,000 million, resulting in cash proceeds of \$3,958 million, net of discounts, issuance costs and the receipt of cash proceeds related to hedges on the interest rate of an anticipated financing. We also increased our short-term borrowings by \$1,831 million.

The net cash proceeds of \$224 million from the increase in our total debt during the nine months ended September 30, 2005 was primarily due to the issuance by Verizon of long-term debt with a total principal amount of \$1,500 million, resulting in total cash proceeds of \$1,478 million, net of discounts and costs, and an increase in our short-term borrowings of \$1,109 million. This increase was largely offset by repayments of long-term debt at Domestic Wireless and Domestic Telecom of \$1,533 million and \$727 million, respectively.

Our ratio of debt to debt combined with shareowners' equity was 47.4% at September 30, 2006 compared with 49.1% at December 31, 2005.

As of September 30, 2006, we had no bank borrowings outstanding. In addition, we had approximately \$6.2 billion of unused bank lines of credit (including a \$6.0 billion three-year committed facility which expires in September 2009 and various other facilities totaling approximately \$400 million) and we had shelf registrations for the issuance of up to \$4.5 billion of unsecured debt securities. The debt securities of Verizon and our telephone subsidiaries continue to be accorded high ratings by primary rating agencies. In order to simplify and streamline our financing entities, Verizon Global Funding merged into Verizon Communications on February 1, 2006. Verizon Communications is now the primary issuer of all long-term and short-term debt for Verizon. The short-term ratings of Verizon Communications are: Moody's P-2; S&P A-1; and Fitch F1. The long-term ratings of Verizon Communications are: Moody's A3 with stable outlook; S&P A with negative outlook; and Fitch A+ with stable outlook. In June 2006, the long-term debt rating of Verizon Wireless was upgraded by Moody's to A2 from A3 and assigned a stable outlook and the long-term debt rating of Verizon Communications was affirmed at A3 with a stable outlook.

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

During the nine months ended September 30, 2006, we repurchased \$1,348 million of our common stock as part of our previously announced common stock repurchase program.

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, second and third quarters of 2006 and 2005, we announced quarterly cash dividends of \$.405 per share.

Cash and Cash Equivalents

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Our cash and cash equivalents at September 30, 2006 totaled \$1,846 million, a \$1,070 million increase from cash and cash equivalents at December 31, 2005 of \$776 million.

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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 collars 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 primarily the local currency. The translation of income statement and balance sheet amounts of our foreign operations 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. We also transact and hold cash balances in foreign currencies. The translation gains and losses of foreign currency transactions and balances are recorded in the condensed consolidated statements of income in Other Income and (Expense), Net and Income from Discontinued Operations, Net of Tax. During the third quarter of 2006, the translation of these cash balances was not material. At September 30, 2006, our primary translation exposure was to the Venezuelan bolivar, the Dominican Republic peso, the British pound and the Euro.

Other Factors That May Affect Future Results

Recent Developments

Spectrum Purchases

On July 7, 2006, the FCC accepted an application that Verizon Wireless filed in June 2006 seeking to qualify to bid on any of the licenses being sold in the Advanced Wireless Services spectrum auction (AWS auction) that commenced on August 9, 2006. On July 17, 2006, Verizon Wireless paid to the FCC a \$383 million deposit, which is included in Other Assets in the accompanying condensed consolidated balance sheets, in order to obtain 256 million bidding eligibility units for participation in the AWS auction. On September 18, 2006 the FCC completed the AWS auction and Verizon Wireless was the high bidder on thirteen 20 MHz licenses with bids totaling \$2,809 million. An additional \$178 million was remitted to the FCC on October 4, 2006. The remaining balance was paid to the FCC on October 19, 2006 and we expect the FCC will grant the licenses in the fourth quarter of 2006 or in the first quarter of 2007.

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 May 13, 2005, the licenses won by Verizon Wireless were granted by the FCC. The licenses won by Vista PCS were granted by the FCC during the first quarter of 2006.

Dispositions of Businesses and Investments

Verizon Dominicana, TELPRI and CANTV

On April 3, 2006, we reached definitive agreements to sell our interests in our Caribbean and Latin American telecommunications operations in three separate transactions to América Móvil, S.A. de C.V., a wireless service provider throughout Latin America, and a company owned jointly by Teléfonos de México, S.A. de C.V. and América Móvil. In those transactions, we agreed to sell our 100% indirect interest in Verizon Dominicana to América Móvil. Also, América Móvil agreed to purchase our 52 percent interest in TELPRI. Additionally, an entity jointly owned by América Móvil and Telmex has agreed to purchase our indirect 28.5 percent interest in CANTV.

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Each transaction is subject to separate regulatory approvals and none of the sales is contingent on the closing of any of the other transactions. We expect to close the sale of our interest in TELPRI in 2006 or 2007. In September 2006, we extended the expiration date of the Verizon Dominicana and CANTV transactions until December 29, 2006. The transactions are expected to close subject to the receipt of regulatory approvals. Although we anticipate pretax gains on the transactions, in the case of Verizon Dominicana, the U.S. taxes that will become payable and be recorded at the time the transaction closes will significantly exceed the amount of the pretax gain. In addition, the government tax authority in the Dominican Republic has issued an assessment of capital gains tax in connection with the proposed transaction. We believe that the assessment is without merit, have filed an appeal and are contesting it vigorously. We are unable to predict the ultimate outcome of this proceeding or its effect on the transaction.

Information Services

In December 2005, we announced that we were reviewing strategic alternatives for the disposition of Information Services. On July 7, 2006 we filed a Form 10 registration statement with the SEC for Verizon Directories Disposition Corporation (VDDC) in a step toward a proposed spin-off of Information Services' domestic print and Internet yellow pages directories to our stockholders. On October 18, 2006 the Verizon Board of Directors approved the proposed spin-off of our U.S. print and Internet yellow pages directories business to our shareholders. The spin-off will result in a new public company, named Idearc Inc., formerly VDDC (Idearc), that will be separate from Verizon. Subject to the satisfaction of certain conditions, the distribution is expected to occur on or about November 17, 2006 and is expected to qualify as a tax-free distribution to our shareholders.

It is expected that the spin-off will result in each shareowner receiving one share of Idearc stock for 20 shares of Verizon for shareowners of record as of November 1, 2006. As a result of the spin-off transaction, Verizon expects to reduce its debt by approximately \$7 billion through a debt-for-debt exchange mechanism and receive approximately \$2 billion in cash. We also expect that the spin-off transaction will result in an after tax charge of \$100 million to \$125 million to our consolidated results, primarily related to costs associated with the transaction. The U.S. print and Internet yellow pages directories results of operations, financial position and cash flows remain in continuing operations in our financial statements until the completion of the spin-off at which time the business will be reported as discontinued operations.

Telephone Access Lines

We continually consider plans for a reduction in the size of our access line business through a spin-off, sale or other disposition, so that we may pursue our strategy of placing greater focus on the higher growth businesses of broadband and wireless.

Cellular Partnership

In August 2002, Verizon Wireless and Price Communications Corp. (Price) combined Price's wireless business with a portion of Verizon Wireless. The resulting limited partnership, Verizon Wireless of the East LP (VZ East), is controlled and managed by Verizon Wireless. In exchange for its contributed assets, Price received a limited partnership interest in the new partnership which was exchangeable into the common stock of Verizon Wireless if an initial public offering of that stock occurred, or into the common stock of Verizon on the fourth anniversary of the asset contribution date. On August 15, 2006, Verizon delivered 29.5 million shares of newly-issued Verizon common stock to Price valued at \$1,007 million in exchange for Price's limited partnership interest in VZ East. The issuance of these shares was previously reflected in the diluted earnings per share as exchangeable equity interest.

Environmental Matters

During 2003, under a government-approved plan, remediation commenced at the site of a former Sylvania facility in Hicksville, New York that processed nuclear fuel rods in the 1950s and 1960s. Remediation beyond original expectations proved to be necessary and a reassessment of the anticipated remediation costs was conducted. A reassessment of costs related to remediation efforts at several other former facilities was also undertaken. As a result, an additional environmental remediation expense of \$240 million was recorded in 2003, for remedial activities likely to take place over the next several years. In September 2005, the Army Corps of Engineers (ACE) accepted the Hicksville site into the Formerly Utilized Sites Remedial Action Program. This may result in the ACE performing some or all of the remaining remediation effort for the Hicksville site with a corresponding decrease in costs to Verizon. To the extent that the ACE assumes responsibility for remedial work at the Hicksville site, an adjustment to the remaining reserve may be necessary. Adjustments may also be made based upon actual conditions discovered during the remediation at any of the other sites requiring remediation.

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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 on lower Manhattan. These funds will be distributed through the Lower Manhattan Development Corporation following an application and audit process. As of September 2004, we had applied for reimbursement of approximately \$266 million under Category One, although we did not record this amount as a receivable. We received advances totaling \$88 million in connection with this application process. 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. On November 3, 2005, we received the results of preliminary audit findings disallowing all but \$44 million of our original \$266 million of costs in our Category One applications. On December 8, 2005, we provided a detailed rebuttal to the preliminary audit findings and are currently awaiting the final audit report. Our applications are pending.

Regulatory and Competitive Trends

Competition and Regulation

Technological, regulatory and market changes have provided Verizon both new opportunities and challenges. These changes have allowed Verizon to offer new types of services in this increasingly competitive market. At the same time, they have allowed other service providers to broaden the scope of their own competitive offerings. Current and potential competitors for network services include other telephone companies, cable companies, wireless service providers, foreign telecommunications providers, satellite providers, electric utilities, Internet service providers, providers of VoIP services, and other companies that offer network services using a variety of technologies. 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. Many of our competitors also remain subject to fewer regulatory constraints than Verizon.

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.

FCC Regulation

Our services are subject to the jurisdiction of the FCC with respect to interstate telecommunications services and other matters for which the FCC has jurisdiction under the Communications Act of 1934, as amended.

Broadband

The FCC has adopted a series of orders that recognize the competitive nature of the broadband market, and impose lesser regulatory requirements on broadband services and facilities than apply to narrowband. With respect to facilities, the FCC has determined that certain unbundling requirements that apply to narrowband facilities do not apply to broadband facilities such as fiber to the premise loops and packet switches. With respect to services, the FCC has concluded that broadband Internet access services offered by telephone companies and their affiliates qualify as largely deregulated information services. The same order also concluded that telephone companies may offer the underlying broadband transmission services that are used as an input to Internet access services through private carriage arrangements on negotiated commercial terms. In addition, a Verizon petition asking the FCC to forbear from applying common carrier regulation to certain broadband services sold primarily to larger business customers when those services are not used for Internet access was deemed granted by operation of law on March 19, 2006 when the FCC did not deny the petition by the statutory deadline. Both the FCC's order addressing the appropriate regulatory treatment of broadband Internet access services and the relief obtained through the forbearance petition are the subject of pending appeals.

Video

The FCC has a body of rules that apply to cable operators under Title VI of the Communications Act of 1934, and these rules also generally apply to telephone companies that provide cable services over their networks. In addition, companies that provide cable service over a cable

system generally must obtain a local cable franchise. The FCC

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currently is conducting a rulemaking proceeding to determine whether the local franchising process is serving as a barrier to entry for new providers of video services, like Verizon. In this proceeding, the FCC is evaluating the scope of its authority over the local franchise process and is considering adopting rules under Section 621 of the Communications Act of 1934 to ensure that the local franchising process does not undermine competitive entry.

Interstate Access Charges and Intercarrier Compensation

The current framework for interstate access rates was established in the Coalition for Affordable Local and Long Distance Services (CALLS) plan, which the FCC adopted on May 31, 2000. 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. As a result of tariff adjustments which became effective in July 2003, virtually all of our switched access lines reached the \$.0055 benchmark.

The FCC currently is conducting a broad rulemaking proceeding to consider new rules governing 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 that this traffic is not subject to reciprocal compensation under Section 251(b)(5) of the Telecommunications Act of 1996. 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. 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. The FCC subsequently denied a petition to discontinue the \$.0007 rate cap on this traffic, but removed the caps on the total minutes of Internet-bound traffic subject to compensation. That decision has been upheld on appeal. 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.

The FCC also is conducting a rulemaking proceeding to address the regulation of services that use Internet protocol, including whether access charges should apply to voice or other Internet protocol 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 previously has held 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, while a service that utilizes Internet protocol for only one intermediate part of a call's transmission is a telecommunications service that is subject to access charges. Another 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. The FCC also declared the services offered by one provider of a voice over Internet protocol service to be jurisdictionally interstate 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.

The FCC also 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. More than half of special access revenues are now removed from price regulation. The FCC currently has a rulemaking proceeding underway to evaluate experience under its pricing flexibility rules, and to determine whether any changes to those rules are warranted.

Universal Service

The FCC also has a body of rules implementing the universal service provisions of the Telecommunications Act of 1996, including rules governing support to rural and non-rural high-cost areas, support for low income subscribers, and support for schools, libraries and rural health care. The FCC's current rules for support to high-cost areas served by larger non-rural local telephone companies were previously remanded by U.S. Court of Appeals for the Tenth Circuit, which had found that the FCC had not adequately justified these rules. The FCC has initiated a rulemaking

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proceeding in response to the court's remand, but its rules remain in effect pending the results of the rulemaking. The FCC also has proceedings underway to evaluate possible changes to its current rules for assessing contributions to the universal service fund. As an interim step, in June 2006, the FCC ordered that providers of VoIP services are subject to federal universal service obligations. The FCC also increased the percentage of revenues subject to federal universal service obligations that wireless providers may use as a safe harbor. Any further change in the current assessment mechanism could result in a change in the contribution that local telephone companies, wireless carriers or others must make and that would have to be collected from customers.

Unbundling of Network Elements

Under section 251 of the Telecommunications Act of 1996, incumbent local exchange carriers were required to provide competing carriers with access to components of their network on an unbundled basis, known as UNEs, where certain statutory standards are satisfied. The Telecommunications Act of 1996 also adopted a cost-based pricing standard for these UNEs, which the FCC interpreted as allowing it to impose a pricing standard known as total element long run incremental cost or TELRIC. The FCC's rules defining the unbundled network elements that must be made available at TELRIC prices have been overturned on multiple occasions by the courts. In its most recent order issued in response to these court decisions, 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. This decision has been upheld on appeal.

As noted above, the FCC has concluded that the requirement under Section 251 of the Telecommunications Act of 1996 to provide unbundled network elements at TELRIC prices generally does not apply with respect to broadband facilities, such as fiber to the premises loops, the packet-switched capabilities of hybrid loops and packet switching. The FCC also has held that any separate unbundling obligations that may be imposed by Section 271 of the Telecommunications Act of 1996 do not apply to these same facilities. The decision with respect to Section 271 has been upheld on appeal. A petition for rehearing of that order is pending.

Recent Accounting Pronouncements

Uncertainty in Income Taxes

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 requires the use of a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in a tax return and disclosures regarding uncertainties in income tax positions. We are required to adopt FIN 48 effective January 1, 2007. The cumulative effect of initially adopting FIN 48 will be recorded as an adjustment to opening retained earnings in the year of adoption and will be presented separately. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized upon adoption of FIN 48. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

Leveraged Leases

In July 2006, the FASB issued Staff Position No. FAS 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction (FSP 13-2). FSP 13-2 requires that changes in the projected timing of income tax cash flows generated by a leveraged lease transaction be recognized as a gain or loss in the year in which change occurs. The pretax gain or loss is required to be included in the same line item in which the leveraged lease income is recognized, with the tax effect being included in the provision for income taxes. We are required to adopt FSP 13-2 effective January 1, 2007. The cumulative effect of initially adopting this FSP will be recorded as an adjustment to opening retained earnings in the year of adoption and will be presented separately. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

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Effects of Prior Year Misstatements

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 requires the quantification of financial statement errors based on the effects on the current year income statement and the cumulative effects on the balance sheet. SAB 108 is effective December 31, 2006 and we expect that the adoption of SAB 108 will not affect our results of operations or financial position.

Fair Value Measurements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurement* (SFAS No. 157). SFAS No. 157 expands disclosures about fair value measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and establishes a hierarchy that categorizes and prioritizes the sources to be used to estimate fair value. We are required to adopt SFAS No. 157 effective January 1, 2008 on a prospective basis. We are currently evaluating the impact this new standard will have on our future results of operations and financial position.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). SFAS No. 158 requires the recognition of a defined benefit postretirement plan's funded status as either an asset or liability on the balance sheet. SFAS No. 158 also requires the immediate recognition of the unrecognized actuarial gains and losses and prior service costs and credits that arise during the period as a component of other accumulated comprehensive income, net of applicable income taxes. Additionally, the fair value of plan assets must be determined as of the company's year-end. We are required to adopt SFAS No. 158 effective December 31, 2006. We expect that the impact of adopting SFAS No. 158 will result in a net decrease to shareowners' investment of approximately \$10 billion. However, the impact of adopting SFAS No. 158 is dependent on plan asset performance through the end of 2006, as well as interest rates and other factors that will be applicable as of December 31, 2006.

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;

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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;

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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;

the timing of the closings of the sales of our Latin American and Caribbean properties; and

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

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 effective.

We completed the merger with MCI on January 6, 2006, at which time MCI became a subsidiary of Verizon. We considered the transaction material to the results of our operations, cash flows and financial position from the date of the acquisition through September 30, 2006, and believe that the internal controls and procedures of MCI have a material effect on our internal control over financial reporting. We are currently in the process of incorporating the internal controls and procedures of the former MCI into our internal controls over financial reporting. The Company has extended its Section 404 compliance program under the Sarbanes-Oxley Act of 2002 and the applicable rules and regulations under such Act to include the former MCI. The Company will report on its assessment of its combined operations within the time period provided by the Act and the applicable SEC rules and regulations concerning business combinations.

There were no other 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, other than the merger with MCI.

Part II - Other Information

Item 1. Legal Proceedings

Verizon and a number of other telecommunications companies have been the subject of multiple class action suits concerning its alleged participation in intelligence-gathering activities allegedly carried out by the federal government, at the direction of the President of the United States, as part of the government's post-September 11 program to prevent terrorist attacks. Plaintiffs generally allege that Verizon has participated by permitting the government to gain access to the content of its subscribers' telephone calls and/or records concerning those calls and that such action violates federal and/or state constitutional and statutory law. Relief sought in the cases includes injunctive relief, attorneys' fees, and statutory and punitive damages. On August 9, 2006, the Judicial Panel on Multidistrict Litigation (Panel) ordered that these actions be transferred, consolidated and coordinated in the U.S. District Court for the Northern District of California. The Panel subsequently ordered that a number of tag along actions also be transferred to the Northern District of California. That court entered an administrative stay of all proceedings before it on September 1, 2006, pending issuance of a consolidated case management order. Motions to set a case management order are pending before the court. Verizon has not answered or otherwise responded to any of the complaints. Verizon believes that these lawsuits are without merit.

In In the Matter of Certain Baseband Processor Chips and Chipsets, Transmitter and Receiver (Radio) Chips, Power Control Chips, and Products Containing Same, Including Cellular Telephone Handsets, an action brought before the United States International Trade Commission, Broadcom Corporation alleges that certain chips and chipsets manufactured by respondent Qualcomm Corporation infringe three Broadcom patents. Broadcom is currently

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seeking a ban on the importation of certain devices containing Qualcomm's EV-DO chipsets, but not with respect to data cards, PDAs, smartphones or handheld email devices containing those chips. Verizon Wireless was granted permission to intervene in the proceeding on the issue of remedy but not on the issue of liability. The ITC staff, which is a party to the proceeding, has supported Broadcom's position with respect to liability and remedy. The trial on remedy was completed on July 11, 2006 before an ITC administrative law judge. The Administrative Law Judge found that Qualcomm has infringed one of the three Broadcom patents and recommended that Qualcomm's chipsets should be excluded from importation into the United States. However, the Administrative Law Judge further recommended that Verizon Wireless handsets that incorporate the Qualcomm EV-DO chipsets should not be subject to an exclusion order. Broadcom is expected to seek review of the recommended decision by the full ITC. The decision of the full ITC is expected to be made by February 9, 2007. During a 60-day period following any exclusion order by the ITC, the President of the United States may disapprove the order. Further, ITC exclusion orders are reviewable by the U.S. Court of Appeals for the Federal Circuit. Disruption of the supply of handsets incorporating Qualcomm EV-DO chipsets could have a material adverse effect on the availability of handsets to sell to Verizon Wireless customers and could therefore have a material adverse effect on its business.

Item 1A. Risk Factors

Information related to our risk factors are disclosed under Item 1A to Part I of our Annual Report on Form 10-K for the year ended December 31, 2005 as amended by Item 1A to Part II of our Form 10-Q for the quarter ended March 31, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about Verizon's common stock repurchases during the third quarter of 2006.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that |
|----------------|----------------------------------|------------------------------|--|---|
| | | | | May Yet Be Purchased Under Existing Plans or Programs |
| July 2006 | 6,250,000 | \$ 32.76 | 6,250,000 | 63,490,200 |
| August 2006 | 2,215,000 | 34.04 | 2,215,000 | 61,275,200 |
| September 2006 | 1,700,000 | 35.96 | 1,700,000 | 59,575,200 |
| | 10,165,000 | | 10,165,000 | 59,575,200 |

On January 22, 2004 Verizon's Board of Directors authorized a common stock repurchase program which authorized total repurchases of up to 80 million common shares and was to expire no later than the close of business on February 28, 2006. On January 19, 2006, the Board of Directors determined that no additional common shares may be purchased under previously authorized programs and gave authorization to repurchase up to 100 million common shares terminating no later than the close of business on February 28, 2008. Under this 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. Under this plan, Verizon may also, from time to time, enter into a Rule 10b5-1 plan, to facilitate repurchases of its shares under this authorization. A Rule 10b5-1 plan permits the company to repurchase shares at times when it might otherwise be prevented from doing so, provided the plan is adopted when the company is not aware of material non-public information.

Item 5. Other Information

On November 2, 2006, Verizon's Board of Directors elected Fran Keeth as a Director, effective December 7, 2006. The committee or committees of the Board to which Ms. Keeth will be appointed have not yet been determined.

On November 2, 2006, Verizon's Board of Directors approved amendments to Article III, Section 3.04(b) and Article IV, Section 4.05 of Verizon's Bylaws to provide for a majority vote standard with respect to the election of directors of Verizon. Pursuant to the amended Bylaws, each director shall be elected by a majority of the votes cast with respect to that director's election at a meeting for the election of directors; provided that, if the number of nominees exceeds the number of directorships to be filled, the directors shall be elected by a plurality of the votes cast. Each director who consents to stand for re-election shall tender an irrevocable resignation in advance of the meeting for the election of

directors of Verizon. The resignation will be effective if the director is not elected by a majority of the

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votes cast and the Board accepts the resignation. The Board approved the amendment of Section 7.06 of the Bylaws to provide that any amendment or repeal of, or the adoption of any Bylaw inconsistent with, the foregoing provisions must be approved by shareholders. This description is qualified in its entirety by reference to the text of the amended Bylaws set forth in Exhibit 3b to this report. The Board also approved the amendment of the Bylaws to delete Section 4.06, which had prescribed, among other things, the order of officers who would preside, in the absence of the Chairman, at any meeting of the Board. The amended Bylaws are effective as of November 2, 2006.

Item 6. Exhibits

(a) Exhibits:

Exhibit

Number

- | | |
|------|---|
| 3b | Bylaws of Verizon, as amended and restated (Exhibit 3b to Form 10K for the year ended December 31, 2005). |
| 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

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: November 6, 2006

By /s/ Thomas A. Bartlett
Thomas A. Bartlett
Senior Vice President and Controller
(Principal Accounting Officer)

UNLESS OTHERWISE INDICATED, ALL INFORMATION IS AS OF OCTOBER 30, 2006.