

VERIZON COMMUNICATIONS INC

Form DEF 14A

March 23, 2015

[Table of Contents](#)

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**SCHEDULE**

**(RULE 14a-101)**

**SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(a) of the Securities**

**Exchange Act of 1934 (Amendment No.    )**

Filed by the Registrant ☒ x

Filed by a Party other than the Registrant ☐ ..

Check the appropriate box:

☐ .. Preliminary Proxy Statement

☐ .. **Confidential, for Use of the Commission Only** (as permitted by Rule 14a-6(e)(2))

☒ x Definitive Proxy Statement

☐ .. Definitive Additional Materials

☐ .. Soliciting Material Pursuant to §240.14a-12

**VERIZON COMMUNICATIONS INC.**

**(Name of Registrant as Specified in Its Charter)**

**(Name of Person(s) Filing Proxy Statement, if other than the Registrant)**

Payment of Filing Fee (Check the appropriate box):

[Table of Contents](#)

- x No fee required.
- .. Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - (1) Title of each class of securities to which transaction applies:
  
  
  
  
  
  
  
  
  
  
  - (2) Aggregate number of securities to which transaction applies:
  
  
  
  
  
  
  
  
  
  
  - (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
  
  
  
  
  
  
  
  
  
  
  - (4) Proposed maximum aggregate value of transaction:
  
  
  
  
  
  
  
  
  
  
  - (5) Total fee paid:
- .. Fee paid previously with preliminary materials.
- .. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.
  - (1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

**Table of Contents**

**Table of Contents**

**NOTICE OF ANNUAL**

**MEETING OF SHAREHOLDERS**

**DATE AND TIME**

Thursday, May 7, 2015

8:30 a.m., local time

**PLACE**

Hyatt Regency Minneapolis

1300 Nicollet Mall

Minneapolis, Minnesota 55403

**ITEMS OF BUSINESS**

Elect the 11 Directors identified in the accompanying proxy statement

Ratify the appointment of the independent registered public accounting firm

Provide an advisory vote to approve Verizon's executive compensation

Act upon the shareholder proposals described in the proxy statement that are properly presented at the meeting

Consider any other business that is properly brought before the meeting

March 23, 2015

By Order of the Board of Directors,

William L. Horton, Jr.

Senior Vice President,

Deputy General Counsel and Corporate Secretary

## How to Vote

If you are a registered shareholder, you may vote online at [www.envisionreports.com/vz](http://www.envisionreports.com/vz), by telephone or by mailing a proxy card.

You may also vote in person at the annual meeting. If you hold your shares through a bank, broker or other institution, or if Computershare holds Crest Depository Instruments representing underlying Verizon shares on your behalf through the Verizon Corporate Sponsored Nominee, you may vote your shares by any method specified on the voting instruction form provided to you. We encourage you to vote your shares as soon as possible.

**Important Notice Regarding Availability of Proxy Materials for Verizon's Shareholder Meeting to be Held on May 7, 2015**

The 2015 Proxy Statement and 2014 Annual Report to Shareholders are available at

[www.edocumentview.com/vz](http://www.edocumentview.com/vz)

Verizon Communications Inc.

1095 Avenue of the Americas

New York, New York 10036

**Verizon** 2015 Proxy Statement

**Table of Contents**

**TABLE OF CONTENTS**

<b>i</b>	<b><u>Proxy Summary</u></b>
<b>1</b>	<b><u>About Verizon's Governance Practices</u></b>
<b>5</b>	<b><u>About Our Board of Directors</u></b>
<b>16</b>	<b><u>Report of the Audit Committee</u></b>
<b>17</b>	<b><u>Election of Directors (Item 1 on Proxy Card)</u></b>
<b>24</b>	<b><u>Ratification of Appointment of Independent Registered Public Accounting Firm (Item 2 on Proxy Card)</u></b>
<b>26</b>	<b><u>Advisory Vote to Approve Executive Compensation (Item 3 on Proxy Card)</u></b>
<b>27</b>	<b><u>Compensation Committee Report</u></b>
<b>28</b>	<b><u>Compensation Discussion and Analysis</u></b>
<b>47</b>	<b><u>Compensation Tables</u></b>
<b>63</b>	<b><u>Security Ownership of Certain Beneficial Owners and Management</u></b>
<b>66</b>	<b><u>Shareholder Proposals</u></b>
<b>66</b>	<b><u>Network Neutrality Report (Item 4 on Proxy Card)</u></b>
<b>68</b>	<b><u>Political Spending Report (Item 5 on Proxy Card)</u></b>
<b>70</b>	<b><u>Severance Approval Policy (Item 6 on Proxy Card)</u></b>
<b>73</b>	<b><u>Stock Retention Policy (Item 7 on Proxy Card)</u></b>
<b>75</b>	<b><u>Shareholder Action by Written Consent (Item 8 on Proxy Card)</u></b>
<b>77</b>	<b><u>Additional Information About the Annual Meeting</u></b>

83 Contacting Verizon

84 Other Business

85 Appendix A. Verizon Communications Inc. Reconciliation of Non-GAAP Measures

Verizon 2015 Proxy Statement



**Table of Contents**

**PROXY SUMMARY**

**i**

**PROXY SUMMARY**

This summary highlights information contained elsewhere in this proxy statement. This summary does not contain all of the information you should consider, and you should read the entire proxy statement before voting. For more complete information regarding Verizon's 2014 performance, please review Verizon's Annual Report to Shareholders.

**Summing Up 2014**

**2014 WAS A TRANSFORMATIONAL YEAR FOR VERIZON**

We set the stage for the next phase of our Company's growth by acquiring full ownership of Verizon Wireless, the leading U.S. wireless company with 108 million retail connections and the largest 4G LTE network in the U.S. With the resulting enhanced operational efficiency, we believe we are well-positioned to meet the challenges of an increasingly competitive industry. Our superior networks put us at the crossroads of the digital economy. In addition, we are partnering with technology and content companies to develop next-generation devices, applications and solutions that will expand the market and drive our growth.

Being at the center of our customers' digital lives in 2014 with secure, reliable services and integrated, connected solutions enabled us to:

Deliver strong, high-quality earnings growth;

Increase our dividend for the 8<sup>th</sup> straight year;

Deliver a total shareholder return of 33.5% over a three-year cycle; and

Continue investing in infrastructure and technology for our future growth.

**Table of Contents**

**PROXY SUMMARY**

**ii**

**2014 WAS A GREENER YEAR FOR VERIZON**

In all of our actions, we aim to use our technology to make us more connected and help solve societal challenges, creating value for our shareholders and the communities we serve.

**PROVIDING PRODUCTS TO CUT EMISSIONS**

Verizon's smart solutions enabled our customers to better manage their buildings and vehicle fleets, run power grids and telecommute—reducing CO<sub>2</sub> emissions by 13.12 million metric tons in 2014. That's the equivalent of taking 3 MILLION cars off the road.

**\$137 MILLION TOWARD GREEN ENERGY**

In the past two years, we've invested \$137 million in solar and fuel-cell technologies for cleaner power for our networks and data centers. We've installed 22 megawatts (MW) of fuel cell and solar photovoltaic systems, with 2.4 MW more on the way. That's equivalent to 2,700 homes' electricity for a year—eliminating 20,000 metric tons of CO<sub>2</sub>.

**RESPONSIBLY RECYCLING OUR EQUIPMENT**

A year ago we set a goal: to recycle 90 million pounds of Verizon assets between 2014 and 2016. By the end of 2014, we had already recycled 42.5 million pounds of wireline assets reaching almost half our three-year goal in just one year.

### Wireline Equipment Recycled in 2014

LEAD ACID BATTERIES	8.9 million pounds
---------------------	--------------------

OTHER BATTERIES*	44.0 thousand pounds
------------------	----------------------

TELECOM EQUIPMENT	33.7 million pounds
-------------------	---------------------

\*Alkaline, nickel cadmium, nickel iron, nickel metal hydride, carbon zinc, zinc air, lithium, ion, lithium metal and magnesium.

### Executive Compensation Program Highlights

Our executive compensation program reflects Verizon's commitment to industry-leading compensation and governance practices. The program is discussed in more detail in the Compensation Discussion and Analysis beginning on page 28.

### OBJECTIVES

Align executives' and shareholders' interests through the use of performance-based compensation

Attract, retain and motivate high-performing executives

### GOVERNANCE LEADER

Say-on-pay advisory vote since 2009

Semiannual shareholder outreach

Shareholder approval policy for severance benefits

Significant executive share ownership requirements

Clawback policy

Anti-hedging policy

Independent compensation consultant since 2006

**PAY-FOR-PERFORMANCE**

Extensive focus on variable, incentive-based pay:

Total compensation opportunity is targeted at median of our peer group

No guaranteed pension or supplemental retirement benefits

No executive employment agreements

No cash severance benefits for the CEO

No excise tax gross-ups

Table of Contents

## PROXY SUMMARY

iii

## 2014 COMPENSATION

The summary below shows the 2014 compensation for each of our named executive officers, as required to be reported in the Summary Compensation Table pursuant to U.S. Securities and Exchange Commission (SEC) rules. Please see the notes accompanying the Summary Compensation Table on page 47 for more information.

Name and Principal Position	Salary and Bonus (\$)		Stock Awards (\$)		Non-Equity	Change in Pension Value and Nonqualified Deferred Compensation (\$)	All Other Compensation (\$)	Total (\$)
					Incentive Compensation (\$)			
LOWELL C. MCADAM	1,580,769	0	12,000,052	0	3,800,000	75,647	850,041	18,306,509
Chairman and Chief								
Executive Officer								
FRANCIS J. SHAMMO	815,385	0	4,331,294	0	1,175,625	12,491	163,956	6,498,751
Executive Vice								
President and Chief								
Financial Officer								
DANIEL S. MEAD	940,385	0	4,987,527	0	1,353,750	160,485	236,157	7,678,304

*Executive Vice President*

*and President of Strategic Initiatives\**

JOHN G. STRATTON	785,577	0	4,200,028	0	1,140,000	30,023	188,530	6,344,158
------------------	---------	---	-----------	---	-----------	--------	---------	-----------

*Executive Vice*

*President and President of Operations\**

RANDAL S. MILCH	714,423	0	3,625,034	0	1,033,125	78,798	168,948	5,620,328
-----------------	---------	---	-----------	---	-----------	--------	---------	-----------

*Executive Vice President\**

\* Mr. Mead served as Executive Vice President and President and CEO Verizon Wireless until February 17, 2015. Mr. Stratton served as Executive Vice President and President Global Enterprise and Consumer Wireline until February 17, 2015. Mr. Milch served as Executive Vice President Public Policy and General Counsel until December 31, 2014.

Meeting Information

For more information about the annual meeting and voting, as well as answers to many frequently asked questions, please see Additional Information About the Annual Meeting section beginning on page 77.

**VOTING**

Shareholders as of the record date, March 9, 2015, are entitled to vote. Each share of Verizon stock is entitled to one vote for each Director candidate and one vote for each of the other proposals to be voted on. If you are a registered shareholder, you may vote your shares by:

**DATE AND LOCATION**

May 7, 2015  
8:30 a.m., local time

Hyatt Regency Minneapolis  
1300 Nicollet Mall  
Minneapolis, Minnesota 55403

Going online to [www.envisionreports.com/vz](http://www.envisionreports.com/vz)

Calling 1-800-652-VOTE (8683) toll-free from the U.S.,

U.S. territories and Canada

Mailing your signed proxy card or voting instruction form

Scanning this QR code

to vote with your mobile device

If you hold your shares through a bank, broker or other institution, or if Computershare Trust Company, N.A. (Computershare) holds Crest Depository Instruments representing underlying Verizon shares (CDIs) on your behalf through the Verizon Corporate Sponsored Nominee, you may vote your shares by any method specified on the voting instruction form provided to you.



**Table of Contents**

**PROXY SUMMARY**

**iv**

Agenda and Voting Recommendations

**Table of Contents**

**ABOUT VERIZON'S GOVERNANCE PRACTICES | Commitment to Good Governance**

**1**

**PROXY STATEMENT**

We are mailing this proxy statement to our shareholders beginning on March 23, 2015, and it is also available online at [www.edocumentview.com/vz](http://www.edocumentview.com/vz) or, if you are a registered holder, at [www.envisionreports.com/vz](http://www.envisionreports.com/vz). The Board of Directors is soliciting proxies in connection with the 2015 Annual Meeting of Shareholders and encourages you to read this proxy statement and vote your shares online, by telephone or by mailing your proxy card or voting instruction form.

**ABOUT VERIZON'S GOVERNANCE PRACTICES**

**Commitment to Good Governance**

The Board of Directors believes that high standards of corporate governance increase value for Verizon's shareholders and enhance the Company's reputation. All of our Directors stand for election each year, and 10 of our 11 Directors standing for re-election this year are independent. Our rigorous director nomination process identifies candidates with the time, skills and experience to contribute to our Company and to engage with management about all aspects of our business. Collectively, the Board embodies a range of viewpoints, backgrounds and expertise because we believe that diversity is an important attribute of a well-functioning Board.

The Board conducts its oversight responsibilities through four standing committees: Audit, Corporate Governance and Policy, Finance and Human Resources. Each committee has a written charter that defines the specific responsibilities of that committee. The committees are discussed in greater detail beginning on page 8.

The Corporate Governance and Policy Committee ensures that the membership, structure, policies and practices of our Board and its committees promote the effective exercise of the Board's role in the governance of Verizon. Our Board has approved Corporate Governance Guidelines that provide a framework for the Board's operation and address key governance practices. The Corporate Governance and Policy Committee monitors developments in corporate governance, considers the views of Verizon's shareholders and periodically recommends changes to the Board's policies and practices, including the Guidelines.

## Where to Find More Information on Governance at Verizon

We have posted Verizon's Corporate Governance Guidelines, Code of Conduct and other corporate governance materials, including Verizon's certificate of incorporation, bylaws, committee charters and policies, on the Corporate Governance section of our website at [www.verizon.com/about/investors/](http://www.verizon.com/about/investors/). You can request copies of these materials from the Assistant Corporate Secretary at the address given under [Contacting Verizon](#).

## Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT VERIZON'S GOVERNANCE PRACTICES** **Key Corporate Governance Provisions**

**2**

**Key Corporate Governance Provisions**

**SHAREHOLDER RIGHTS**

**Majority voting in  
Director elections**

Verizon's bylaws provide for the election of Directors by a majority of the votes cast in uncontested elections. This provision can only be changed by a majority vote of the shareholders.

**Shareholder right to  
call a special meeting of  
shareholders**

Any shareholder owning at least 10% (or any group of shareholders owning at least 25%) of Verizon's outstanding common stock may call a special meeting of shareholders. Please see our bylaws for requirements relating to special meetings.

**Proxy access right for  
shareholders**

Any shareholder (or any group of up to 20 shareholders) owning at least 3% of Verizon's outstanding common stock for at least three years may include a specified number of director nominees in our proxy materials for the annual meeting of shareholders. Please see our bylaws for details about qualifying stock ownership, the number of permitted nominees, and other requirements relating to proxy access.

**Shareholder approval of poison  
pill**

Verizon does not have a shareholder rights plan, commonly referred to as a poison pill. Any shareholder rights plan adopted by the Board must be approved

by shareholders within one year and then re-approved every three years.

Shareholder ratification of  
executive severance agreements

Any employment or severance agreement with an executive officer that provides for severance benefits exceeding 2.99 times the sum of the executive's base salary plus non-equity incentive plan payment must be ratified by shareholders. This policy is described in more detail beginning on page 45.

Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT VERIZON'S GOVERNANCE PRACTICES** **Key Corporate Governance Provisions**

**3**

**BOARD OF DIRECTORS**

**Director independence**

All of our non-employee Directors are independent, and the standards that our Board uses to assess independence are more stringent than those of the New York Stock Exchange (NYSE) or The NASDAQ Stock Market (Nasdaq). For more information about the independence of the non-employee Directors, see [Independence](#) on page 5.

**Board leadership**

Currently, the CEO serves as Chairman of the Board, in consultation with the Lead Director. You can read more about the respective roles and responsibilities of the Chairman and Lead Director, and why the Board believes that Verizon's shareholders are best served by this leadership structure, under [Board Leadership](#) on page 6.

**Limits on board service**

Under the Guidelines, a Director who serves as an executive officer of a public company should not serve on the board of more than three public companies, including the board of the company that employs him or her. Other Directors should not serve on more than six public company boards.

**Stock ownership**

Directors must hold Verizon stock with a value equal to three times the cash component of the annual Board retainer. Shares held in any deferral plan are included when calculating the number of shares held. Directors have three years to meet the requirement.

Director retirement

A Director will retire from the Board the day before the annual meeting of shareholders that follows his or her 72<sup>nd</sup> birthday. The size of the Board is reduced by one for each such retirement.

Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT VERIZON'S GOVERNANCE PRACTICES** **Business Conduct and Ethics**

**4**

**Business Conduct and Ethics**

We are committed to operating our business with the highest level of integrity, responsibility and accountability. We have adopted a Code of Conduct that applies to all employees, including the Chief Executive Officer (CEO), the Chief Financial Officer and the Controller. The Code of Conduct describes each employee's responsibility to conduct business with the highest ethical standards and provides guidance in preventing, reporting and remediating potential compliance violations in key areas. Directors are expected to act in the spirit of the Code of Conduct, as well as comply with the specific ethical provisions of the Corporate Governance Guidelines. The Board is strongly predisposed against waiving any of the business conduct and ethics provisions applicable to Directors or executive officers. In the event of a waiver, we will promptly disclose the Board's action on our website.

**Related Person Transactions**

The Board has adopted the Related Person Transaction Policy that is included in the Guidelines. The Corporate Governance and Policy Committee reviews transactions between Verizon and any of our Directors or executive officers or members of their immediate families to determine if any of the individual participants has a material interest in the transaction. Based on the facts and circumstances of each case, the Committee may approve, disapprove, ratify or cancel the transaction or recommend another course of action. Any member of the Committee who is involved in a transaction under review cannot participate in the Committee's decision about that transaction.

From time to time Verizon may have employees who are related to our executive officers or Directors. Lowell C. McAdam, Chairman and CEO, has a child who is employed by a Verizon subsidiary and earned approximately \$120,034 in 2014. Francis J. Shammo, Executive Vice President and Chief Financial Officer, has an in-law who is employed by a Verizon subsidiary and earned approximately \$375,570 in 2014. W. Robert Mudge, Executive Vice President - Wireline Operations, has a sibling who is employed by a Verizon subsidiary and earned approximately \$139,045 in 2014. In each case, the amount of compensation was commensurate with that of other employees in similar positions.



Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Independence**

**5**

**ABOUT OUR BOARD OF DIRECTORS**

This section describes key aspects of the Board's composition, governance and operation that contribute to its ability to effectively oversee the Company's business, provide quality advice to the leadership team and act in the long-term best interests of shareholders.

**Independence**

Verizon's Corporate Governance Guidelines require that a substantial majority of the Directors be independent and establish standards for evaluating independence. To be considered independent, the Board must find that a Director is independent under NYSE and Nasdaq governance standards as well as the more stringent standards included in the Guidelines. These standards identify the types of relationships that, if material, could impair independence and the monetary thresholds at which the relationships are considered to be material. The Corporate Governance and Policy Committee conducts an annual review of all relevant business relationships that each Director may have with the Company and reports its findings to the full Board. Based on the recommendation of the Committee, the Board has determined that all of the incumbent non-employee Directors who are standing for election are independent: Shellye Archambeau, Mark Bertolini, Richard Carrión, Melanie Healey, M. Frances Keeth, Donald Nicolaisen, Clarence Otis, Jr., Rodney Slater, Kathryn Tesija and Gregory Wasson. The Board also determined that Sandra Moose, Joseph Neubauer and Hugh Price, all of whom retired from the Board on April 30, 2014, and Robert Lane, who is not standing for re-election, were independent.

In determining the independence of Ms. Archambeau, Mr. Bertolini, Mr. Carrión, Ms. Healey, Mr. Neubauer, Mr. Otis, Mr. Price, Mr. Slater, Ms. Tesija and Mr. Wasson, the Board considered payments made by these Directors employers to Verizon for telecommunications services and solutions. In determining Mr. Bertolini's independence, the Board also considered payments that Verizon made to the company that employs him under

Verizon 2015 Proxy Statement

---

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Board Leadership**

**6**

a professional services contract for employee healthcare benefits. In determining Mr. Neubauer's independence, the Board also considered payments that Verizon made to the company that employed him under a competitively bid contract for food and facility management services. In determining Ms. Tesija's independence, the Board also considered payments that Verizon made to the company that employs her in connection with sales of Verizon's products and services at that company's stores and payments that that company made to Verizon for cyber security services. In determining Mr. Wasson's independence, the Board also considered payments that Verizon made to the company that employed him in connection with lease payments and wireless service rebates. In applying the independence standards, the Board has determined that these general business transactions and relationships are not material and did not impair the ability of those Directors to act independently.

**Board Leadership**

Each year, the Board evaluates whether its leadership structure is appropriate to effectively address the specific needs of the business and the long-term interests of shareholders. Given the dynamic and competitive environment in which Verizon operates, the Board believes that the Company and its shareholders are best served by a Chairman who has broad and deep knowledge of Verizon's business operations and the competitive landscape, the ability to identify strategic issues and the vision to create sustainable long-term value for shareholders. Based on these considerations, the Board has determined that, at this time, our CEO, Lowell McAdam, is the Director best qualified to serve in the role of Chairman.

To maintain an appropriate level of independent checks and balances in its governance, consistent with the Guidelines, the Board has also elected an independent Lead Director who has the authority to call meetings of the Board and executive sessions. M. Frances Keeth is currently serving as Lead Director. In addition, the Lead Director:

Chairs executive sessions, including those held to evaluate the CEO's performance and compensation;

Chairs any meeting of the Board if the Chairman is not present;

Approves the schedule, agenda and materials for all Board meetings, in consultation with the Chairman;

Acts as principal liaison with the Chairman; and

Leads the Board's annual self-evaluation.

Any shareholder or interested party may communicate directly with the Lead Director.

Importantly, all Directors play an active role in overseeing the Company's business at both the Board and committee level. The agenda for each Board and committee meeting is available to all Directors in advance so that any Director can review and request changes. In addition, all Directors have unrestricted access to the Chairman and senior leadership team at all times.

The Board believes that Shareholders are best served by the Board's current leadership structure because it provides the ability to maintain independent and objective oversight with an independent Lead Director, who can express the Board's positions in a forthright manner, and independent Directors who are fully involved in the Board's operations and decision making.

Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Board Meetings and Executive Sessions**

**7**

**Board Meetings and Executive Sessions**

In 2014, the Board of Directors held 11 meetings, including 7 regularly scheduled meetings and 4 special meetings. No Director standing for election attended fewer than 75% percent of the total number of meetings of the Board and the committees to which the Director was assigned.

Directors standing for re-election are expected to attend the annual meeting of shareholders. In 2014, all but two Directors standing for re-election attended the annual meeting.

The Corporate Governance Guidelines require the independent Directors to meet in executive session without any members of management present at least twice a year to review and evaluate the performance of the Board and to evaluate the performance and approve the compensation of the CEO. In practice, they typically meet in executive session during each regular Board meeting.

**Annual Board and Committee Evaluations**

The Board conducts an annual self-assessment aimed at enhancing its effectiveness. As part of the assessment, each Director completes a written questionnaire designed to gather suggestions to improve Board effectiveness and solicit additional feedback on a range of issues, including Board operations, Board and committee structure and dynamics, the flow of information received from management, and agenda topics. In addition, the Lead Director conducts individual interviews with each of the independent Directors to discuss these topics. The feedback received from the questionnaires and interviews is discussed during an evaluation session.

Each of the four standing committees also conducts its own annual self-assessment, which includes a written questionnaire and evaluation session. These evaluation sessions are led by the committee chairs and generally include a review of the committee charter, the annual agenda, and the committee's overall effectiveness.

In addition to these annual self-assessments, the Board evaluates and modifies its oversight of the Company's operations on an ongoing basis. During executive sessions of the Board, among other things, the independent Directors consider agenda topics that they believe deserve additional focus and topics to be included in future meetings.

The Corporate Governance and Policy Committee annually appraises the framework for the Board and committee evaluation processes.

#### Example of Result of Self-Assessment

In 2013, Verizon agreed to purchase the remaining interest in Verizon Wireless that it did not already own. Because the Company was going to incur significant additional debt in order to complete this acquisition, the Board determined that it should increase its oversight of the Company's cash flows and liquidity through the creation of a Finance Committee of Directors with significant financial expertise.

#### Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Committees of the Board**

8

Committees of the Board

The Board of Directors has established four standing committees – the Audit Committee, the Corporate Governance and Policy Committee, the Finance Committee and the Human Resources Committee. Each committee has a written charter that defines the specific responsibilities of that committee. The Chairperson of each committee approves the agenda and materials for each meeting. Each committee has the authority to retain independent advisors to assist it in carrying out its responsibilities.

**AUDIT COMMITTEE**

MEETINGS IN 2014: 11

MEMBERS:

Donald Nicolaisen (CHAIRPERSON)

Shellye Archambeau

**KEY RESPONSIBILITIES:**

Assess Verizon's significant business risk exposures (including those related to data privacy and network security) and oversee the risk management program;

Assess the adequacy of the Company's overall control environment;

Oversee financial reporting and disclosure matters;



<p>M. Frances Keeth</p> <p>Clarence Otis, Jr.</p> <p>Gregory Wasson</p> <p><i>Ms. Archambeau joined the Audit Committee on September 4, 2014</i></p>	<p>Appoint, approve fees and oversee work of the independent registered public accounting firm;</p> <p>Oversee Verizon's internal audit function;</p>
<p>The Board has determined that each member of the Committee is an audit committee financial expert and meets the independence requirements of applicable law, the NYSE, Nasdaq and the Guidelines.</p> <p>The report of the Audit Committee is included on page 16.</p>	<p>Assess Verizon's compliance processes and programs;</p> <p>Assess policies and procedures for executive officer expense accounts and perquisites, including the use of corporate assets; and</p> <p>Assess procedures for the handling of complaints relating to accounting, internal accounting controls or auditing matters.</p>

Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Committees of the Board**

**9**

**CORPORATE GOVERNANCE  
AND POLICY COMMITTEE**

MEETINGS IN 2014: 7

**MEMBERS:**

M. Frances Keeth (CHAIRPERSON)

Shellye Archambeau

Richard Carrión

Donald Nicolaisen

**KEY RESPONSIBILITIES:**

Evaluate the structure and practices of the Board and its committees, including size, composition, independence and operations;

Recommend changes to the Board's policies or practices or the Guidelines;

Identify and evaluate the qualifications of Director candidates;

Recommend Directors to serve as members of each committee of the Board and as committee chairs;

Review potential related person transactions; and

Rodney Slater

Kathryn Tesija

*Ms. Archambeau joined the Corporate Governance and Policy Committee on September 4, 2014*

Review Verizon's position and engagement on important public policy issues that may affect its business and reputation, including political contributions and corporate social responsibility.

The Board has determined that each member of the Committee meets the independence requirements of applicable law, the NYSE, Nasdaq and the Guidelines.

## FINANCE COMMITTEE

MEETINGS IN 2014: 4

MEMBERS:

Richard Carrión (CHAIRPERSON)

M. Frances Keeth

Robert Lane

Clarence Otis, Jr.

### KEY RESPONSIBILITIES:

Monitor Verizon's capital needs and financing arrangements and ability to access the capital markets;

Monitor expenditures under the annual capital plan approved by the Board;

Review and approve Verizon's derivatives policy and monitor the use of derivatives;

Review Verizon's insurance and self-insurance programs; and

The Board has determined that each member of the Committee meets the independence requirements of applicable law, the NYSE, Nasdaq and the Guidelines.

Oversee the investment of pension assets and the funding of pension and other postretirement benefit obligations.

Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Role of the Independent Compensation Consultant**

**10**

**HUMAN RESOURCES COMMITTEE**

MEETINGS IN 2014: 6

**MEMBERS:**

Clarence Otis, Jr. (CHAIRPERSON)

Richard Carrión

Melanie Healey

Gregory Wasson

**KEY RESPONSIBILITIES:**

Oversee the development of Verizon's executive compensation programs and policies;

Approve corporate goals relevant to the CEO's compensation;

Evaluate the CEO's performance and recommend his compensation to the Board;

Review and approve compensation and benefits for selected senior managers;

Review the impact of Verizon's executive compensation policies and practices, and the performance metrics underlying the compensation programs, on Verizon's risk profile;

The Board has determined that each member of the Committee meets the independence requirements of applicable law, the NYSE, Nasdaq and the Guidelines.

Consult with the CEO on talent development; and

Review and recommend to the Board non-employee Director compensation.

The report of the Human Resources Committee is included on page 27.

The Human Resources Committee makes an independent determination on all matters related to the compensation of the named executive officers. In making its determination, the Committee may seek the CEO's views on whether the existing compensation policies and practices continue to support Verizon's business and performance objectives, utilize appropriate performance goals, and appropriately reward the contributions of the other named executive officers to that performance.

The Committee may also consult with the Executive Vice President and Chief Administrative Officer (CAO) about the design, administration and operation of the Company's compensation program. The Committee has delegated administrative responsibility for implementing its decisions on compensation and benefits matters to the CAO, who reports to the Committee on the actions taken under this delegation.

#### Role of the Independent Compensation Consultant

The Human Resources Committee has the sole authority to retain and terminate a compensation consultant and to approve the consultant's fees and all other terms of the engagement. The Committee has retained Pearl Meyer & Partners as its compensation consultant (Consultant) based on the firm's independence and expertise in representing the compensation committees of large corporations. The Consultant advises the Committee on all matters related to the compensation of our named executive officers, provides benchmarking data and helps the Committee interpret this data, as well as data provided by the Company. The Consultant participates in all Committee meetings. The Committee typically holds an executive session with the Consultant at every Committee meeting.

The Committee has adopted a policy that prohibits the Consultant from doing any work for the Company during its engagement. Neither Pearl Meyer & Partners nor its affiliates have performed any work for the Company or any Company affiliate since 2006, when the Committee retained the Consultant.

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Nomination of Candidates for Director**

**11**

The Committee has considered the independence of Pearl Meyer & Partners in light of SEC rules and NYSE and Nasdaq listing standards. At the Committee's request, Pearl Meyer & Partners provided a letter addressing its independence, including the following factors:

No other services provided to the Company by the Consultant;

Fees paid by the Committee as a percentage of the Consultant's total revenue;

Policies or procedures maintained by the Consultant that are designed to prevent a conflict of interest;

Any business or personal relationships between the individual consultants involved in the engagement and a member of the Committee;

Any Company stock owned by the individual consultants involved in the engagement; and

Any business or personal relationships between our executive officers and the Consultant or the individual consultants involved in the engagement.

The Committee has concluded that no conflict of interest exists that would prevent Pearl Meyer & Partners from serving as an independent consultant to the Committee.

**Nomination of Candidates for Director**

The Corporate Governance and Policy Committee considers and recommends candidates for the Board. It reviews all nominations submitted to Verizon, including individuals recommended by shareholders, Directors or members of management as well as proxy access candidates. The Committee has also retained Heidrick & Struggles International,

Inc. to assist in the identification and evaluation of potential candidates. Any shareholder who wishes to nominate a candidate for Director may do so by following the procedure described on page 82. We will report any material change to this procedure in a filing with the SEC and will post the information on the Corporate Governance section of our website at [www.verizon.com/about/investors/](http://www.verizon.com/about/investors/).

### Requirements for Board Candidates

To be eligible for consideration, any proposed candidate must:

Be ethical;

Have proven judgment and competence;

Have professional skills and experience in dealing with a large, complex organization or in dealing with complex problems that are complementary to the background and experience represented on the Board and that meet the needs of Verizon;

Have demonstrated the ability to act independently and be willing to represent the interests of all shareholders and not just those of a particular philosophy or constituency; and

Be willing and able to devote sufficient time to fulfill his or her responsibilities to Verizon and its shareholders.

Verizon 2015 Proxy Statement



---

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Risk Oversight**

**12**

The Committee recognizes that a diverse set of viewpoints and practical experiences enhances the effectiveness of the Board. In evaluating candidates, the Committee considers a wide variety of qualifications, attributes and other factors, taking into account how a candidate's particular background, experience, qualifications, attributes and skills may complement, supplement or duplicate those of other prospective candidates.

The Committee specifically reviews the qualifications of each candidate for election or re-election. For incumbent Directors, this review includes the Director's understanding of Verizon's businesses and the environment within which Verizon operates, attendance and participation at meetings, and independence. After the Committee has completed its evaluation of all candidates, it presents its recommendation to the Board for consideration and approval. The Committee also discusses with the Board any candidates who were submitted to and considered by the Committee but not recommended for election or re-election as well as any proxy access candidates.

Prior to nomination, each candidate for election and each incumbent Director standing for re-election must consent to stand for election or re-election and provide certain representations required under the Company's bylaws. They must also submit an irrevocable resignation which will only become effective if (i) the Board or any Committee determines that any of the representations required under the Company's bylaws as referenced above were untrue in any respect or (ii) the candidate does not receive a majority of the votes cast at the annual meeting of shareholders and the independent members of the Board decide to accept the resignation. Any decision regarding accepting a resignation following a failure to obtain a majority of the votes cast will be disclosed within 90 days after the election results are certified.

**Risk Oversight**

**ROLE OF THE BOARD**

While senior management has primary responsibility for managing risk, the Board of Directors has responsibility for risk oversight. The Board works with senior management to develop a broad portfolio view that considers and balances risk-taking for sustainable growth and competitive advantage in a manner consistent with Verizon's long-term strategic plan with actions necessary to preserve Verizon's assets and protect it against losses. Board and committee oversight is enabled by management reporting processes that are designed to provide visibility to the Board about the identification, assessment and management of critical risks and management's risk mitigation strategies.

In performing its oversight role, the Board:

Addresses the primary risks associated with the Company's business units and corporate functions in its operations reviews of those units and functions.

Reviews the risks associated with the Company's strategic plan at an annual strategic planning session and periodically throughout the year.

Verizon 2015 Proxy Statement

---

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Risk Oversight**

**13**

In addition, Verizon has a robust enterprise risk management program that is overseen by the Audit Committee as described below.

**ROLE OF THE COMMITTEES**

Each of the Board's committees oversees the management of Company risks that fall within that committee's areas of responsibility. In performing this function, each committee has full access to management and may engage advisors.

Audit Committee	<p>Oversees the operations of Verizon's enterprise risk management program, which identifies the primary risks to the Company's business.</p> <p>Periodically monitors and evaluates the primary risks associated with particular business units and functions.</p> <p>Works with Verizon's Senior Vice President – Internal Auditing, who assists the Company in identifying, evaluating and implementing risk management controls and methodologies to address identified risks and who functionally reports directly to the Committee.</p> <p>Meets privately at each meeting with representatives from the Company's independent registered public accounting firm, the Company's Senior Vice President – Internal Auditing, and the Company's Executive Vice President – Public Policy and General Counsel.</p> <p>Reports to the full Board on these activities.</p>
Corporate Governance and Policy Committee	<p>Reviews business and reputational risks relating to Verizon's position and engagement on important public policy issues, including political contributions and corporate social responsibility.</p>

Finance Committee

Assists the Board in its oversight of financial risk management.

Monitors the Company's capital needs and financing plans and oversees its strategy for managing risk related to currency and interest rate exposure.

Reviews and approves Verizon's derivatives policy and monitors the use of derivatives.

Reviews the Company's insurance and self-insurance programs, as well as its pension and other postretirement benefit obligations.

Human Resources Committee

As part of its oversight of the Company's executive compensation program, considers the impact of the program and of the incentives created by the compensation awards on the Company's risk profile.

Verizon 2015 Proxy Statement

---

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Succession Planning and Management Development**

**14**

Oversees management's annual assessment of compensation risk arising from Verizon's compensation policies and practices, which includes a review of the following compensation policies and practices and other internal controls that reduce risk:

Design features and characteristics of our company-wide compensation programs;

Performance metrics under the Short- and Long-Term Incentive Plans;

Approval processes for all compensation programs, including those for associate sales and non-sales employees;

Governance oversight at the Board and committee level; and

Code of Conduct provisions and mandatory training programs that lessen risk.

Based on management's review, the Company has concluded that its compensation policies and procedures are not reasonably likely to have a material adverse effect on the Company because they are appropriately structured and discourage employees from taking excessive risks.

**Succession Planning and Management Development**

Verizon's Board of Directors recognizes that one of its most important duties is to ensure continuity in the Company's senior leadership by overseeing the development of executive talent and planning for the efficient succession of the Company's CEO. In accordance with the Corporate Governance Guidelines, the Board addresses CEO succession and management development on an ongoing basis throughout the year. The Board has delegated primary oversight responsibility for succession planning to the Human Resources Committee, which oversees assignments to key leadership positions. The Committee reports on its activities to the full Board, which addresses succession planning during executive sessions that typically occur in connection with each regularly scheduled meeting.

To ensure that the succession planning and management development process supports and enhances Verizon's

strategic objectives, the Board and Committee regularly consult with the CEO on the Company's organizational needs, its competitive challenges, the potential of key managers and planning for future developments and emergency situations. As part of this process, the Board and Committee also routinely seek input from the CAO, as well as advice on related compensation issues from the Committee's Consultant.

Verizon 2015 Proxy Statement

**Table of Contents**

**ABOUT OUR BOARD OF DIRECTORS | Communicating with Directors**

**15**

The Board generally conducts its annual in-depth review of senior leader development and succession planning in conjunction with its annual strategic planning session with management. Led by the CEO and CAO, this review addresses the Company's management development initiatives, assesses senior management resources and identifies individuals who should be considered as potential future senior executives.

Our goal is to develop well-rounded and experienced senior leaders. High potential executives are regularly challenged with additional responsibilities, new positions, promotions or similar assignments to expose them to diverse operations within the Company. These individuals are also often positioned to interact more frequently with the Board so that the Directors can get to know and assess these executives.

**Communicating with Directors**

The Board of Directors believes that communication with shareholders and other interested parties is an important part of the governance process and has adopted the following procedure to facilitate this communication.

**How to Contact the Board**

Any shareholder or interested party may communicate directly with the Board, any committee of the Board, any individual Director (including committee chairs and the Lead Director) or the non-employee Directors as a group, by writing to:

**Verizon Communications Inc.**

**Board of Directors**

**(or committee name, individual Director,**

**committee chair, Lead Director or**

**non-employee Directors as a group, as appropriate)**

1095 Avenue of the Americas

New York, New York 10036

Verizon's Corporate Secretary reviews all communications addressed to our Directors and periodically provides to the Board copies of all communications that deal with the functions of the Board or its committees, or that otherwise require Board attention. Communications involving substantive accounting or auditing matters are forwarded to the Chair of the Audit Committee. Typically the Corporate Secretary will not provide communications that are of a personal nature or are unrelated to the duties and responsibilities of the Board, including: business solicitations or advertisements; mass mailings; job-related inquiries; or other unsuitable communications.

Verizon 2015 Proxy Statement



**Table of Contents**

**REPORT OF THE AUDIT COMMITTEE**

**16**

**REPORT OF THE AUDIT COMMITTEE**

In the performance of our oversight responsibilities, the Committee has reviewed and discussed with management and the independent registered public accounting firm Verizon's audited financial statements for the year ended December 31, 2014 and the effectiveness of Verizon's internal controls over financial reporting as of December 31, 2014.

The Committee has discussed with the independent registered public accounting firm the matters required to be discussed by the Securities and Exchange Commission, the New York Stock Exchange, The NASDAQ Stock Market and Statement on Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T.

The Committee has received the written disclosures and the letter from the independent registered public accounting firm consistent with applicable Public Company Accounting Oversight Board requirements for independent registered public accounting firm communications with audit committees concerning independence and has discussed with the independent registered public accounting firm its independence.

The Committee discussed with the internal auditors and the independent registered public accounting firm the overall scope and plans for their respective audits. The Committee met with the internal auditors and the independent registered public accounting firm, with and without management present, to discuss the results of their examinations, their evaluations of Verizon's internal controls and the overall quality of Verizon's financial reporting.

The Committee has overseen the operation of Verizon's enterprise risk management program, including the identification of the primary risks to the Company's business. The Committee has also periodically monitored and evaluated the primary risks associated with particular business units and functions.

Based on the reviews and discussions referred to above, in reliance on management and the independent registered public accounting firm, and subject to the limitations of our role, the Committee recommended to the Board of Directors, and the Board has approved, the inclusion of the financial statements referred to above in Verizon's Annual Report on Form 10-K for the year ended December 31, 2014.

The Committee reviewed the independent registered public accounting firm's performance, qualifications and tenure, the qualifications of the lead engagement partner, management's recommendation regarding retention of the firm and considerations related to audit firm rotation, as discussed further on page 24. Based on that review, the Committee approved the reappointment of the independent registered public accounting firm for the fiscal year 2015.

Respectfully submitted,

The Audit Committee

*Donald Nicolaisen, Chairperson*

*Shellye Archambeau*

*M. Frances Keeth*

*Clarence Otis, Jr.*

*Gregory Wasson*

Dated: March 4, 2015

Verizon 2015 Proxy Statement

**Table of Contents**

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**17**

**ELECTION OF DIRECTORS** (Item 1 on Proxy Card)

Verizon's directors are elected annually. The Company believes annual elections are consistent with good corporate governance because they foster director accountability and increase shareholder confidence. Verizon's Board currently has 12 members. The Board periodically evaluates whether a larger or smaller board would be preferable, depending upon the needs of the Board and the availability of qualified candidates.

The Board has nominated the 11 candidates below for election as Directors. All of these candidates currently serve as Directors of Verizon. Mr. Bertolini was appointed to the Board in February 2015 as an independent Director and was recommended for consideration as a candidate by the Chairman. The Corporate Governance and Policy Committee and the Board concluded that each of these incumbent Directors should be nominated for re-election based on the experience, qualifications, attributes and skills identified below. The Committee and the Board assessed these factors in light of Verizon's businesses, which provide a broad array of wireless and wireline telecommunications products, services and solutions to individuals, businesses, governments and wholesale customers in the United States and around the world.

Each candidate has consented to stand for election, and we do not anticipate that any candidate will be unavailable to serve. If any candidate were to become unavailable before the election, the proxy committee would vote the shares it represents for a substitute named by the Board.

Verizon's bylaws require Directors to be elected by a majority of the votes cast. Each candidate has submitted an irrevocable, conditional letter of resignation that the Board will consider if that candidate fails to receive a majority of the votes cast.

**Table of Contents**

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**18**

**Shellye L. Archambeau**

**BACKGROUND**

Ms. Archambeau is Chief Executive Officer of MetricStream, Inc., a leading provider of governance, risk, compliance and quality management solutions to corporations across diverse industries. Prior to joining MetricStream in 2002, Ms. Archambeau served as Chief Marketing Officer and Executive Vice President of Sales for Loudcloud, Inc., Chief Marketing Officer of NorthPoint Communications, and President of Blockbuster Inc.'s e-commerce division. Before she joined Blockbuster, she held domestic and international executive positions during a 15-year career at IBM. Ms. Archambeau has served on the board of Nordstrom, Inc. since February 2015 and, in the past five years, she has served on the board of Arbitron, Inc.

**QUALIFICATIONS**

Ms. Archambeau provides the Board with valuable knowledge of technology, e-commerce, digital media and communications platforms. Her experiences in the Silicon Valley emerging company community, as well as her prior experience at IBM, provide her with global perspectives on developing and marketing emerging technology applications and solutions.

Mark T. Bertolini

## BACKGROUND

Mr. Bertolini is Chairman and Chief Executive Officer of Aetna Inc., a Fortune 100 diversified healthcare benefits company with \$58.0 billion in 2014 revenue. Prior to assuming the role of Aetna's CEO in 2010 and Chairman in 2011, Mr. Bertolini served as President from 2007, responsible for all of Aetna's businesses and operations across the company's range of healthcare products and related services, and as Executive Vice President and head of Aetna's regional businesses prior to that. He joined Aetna in 2003 as head of Aetna's Specialty Products after holding executive positions at Cigna, NYLCare Health Plans and SelectCare, Inc.

## QUALIFICATIONS

Mr. Bertolini's experience at a large, multinational corporation provides the Board with valuable operational and management expertise, as well as critical perspective on strategic planning. His role as Chairman and CEO of Aetna provides the Board with additional insights into the healthcare industry—an area of increasing importance to Verizon's business strategy.

Verizon 2015 Proxy Statement

Table of Contents

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**19**

**Richard L. Carrión**

**BACKGROUND**

Mr. Carrión has served for over 19 years as Chairman and Chief Executive Officer of Popular, Inc., a diversified bank holding company, and Banco Popular de Puerto Rico, Popular Inc.'s principal bank subsidiary. Mr. Carrión has served as a class A director of the Federal Reserve Bank of New York since 2008. He also served as a director of NYNEX Corporation, one of Verizon's predecessor companies, from 1995 to 1997.

**QUALIFICATIONS**

Mr. Carrión provides the Board with financial, operational and strategic expertise developed during his long tenure as Chairman and CEO of Popular, Inc. and Banco Popular de Puerto Rico. This experience, combined with his board service at the Federal Reserve Bank of New York, also provides the Board with deep risk management expertise.

Melanie L. Healey

## BACKGROUND

Ms. Healey is Group President and Advisor to the Chairman and Chief Executive Officer of The Procter & Gamble Company, one of the world's leading providers of branded consumer packaged goods. Prior to assuming her current role, Ms. Healey served as Group President of North America. Since joining Procter & Gamble in 1990, Ms. Healey has held a number of positions of responsibility, including Group President, Global Feminine and Health Care, and President, Global Feminine Care & Adult Care.

## QUALIFICATIONS

Ms. Healey provides the Board with valuable strategic, branding, distribution and operating experience on a global scale obtained over her 32-year career in the consumer goods industry in three multinational companies (Procter & Gamble, Johnson & Johnson and S.C. Johnson & Sons). Her deep experience in marketing, including her 18 years outside the United States, provides the Board with strategic and operational leadership and critical insights into brand building and consumer marketing trends globally.

Verizon 2015 Proxy Statement

**Table of Contents**

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**20**

**M. Frances Keeth (Lead Director)**

**BACKGROUND**

Ms. Keeth was Executive Vice President of Royal Dutch Shell plc, a global energy company, from 2005 to 2006, and was President and Chief Executive Officer of Shell Chemicals LP from 2001 to 2006. During her long tenure at Royal Dutch Shell, Ms. Keeth served in a number of other positions of responsibility, including Executive Vice President, Finance and Business Systems, and Executive Vice President, Customer Fulfillment and Product Business Units. Prior to these positions, Ms. Keeth was controller and principal accounting officer of Mobil Corporation. Ms. Keeth has served as a director of Arrow Electronics, Inc. since 2004 and, in the past five years, she has served as a director of Peabody Energy Corporation.

**QUALIFICATIONS**

Ms. Keeth's career with Shell has provided her with substantial experience in managing worldwide operations and strategic partnerships in a capital-intensive business. Her expertise provides the Board with critical skills in the areas of financial oversight, aligning financial and strategic initiatives, and risk management.



Lowell C. McAdam (Chairman)

BACKGROUND

Mr. McAdam is Chairman and Chief Executive Officer of Verizon Communications Inc. Mr. McAdam has served as CEO since 2011 and Chairman since 2012. Prior to becoming CEO, Mr. McAdam served in numerous positions of responsibility, including President and Chief Operating Officer of Verizon Communications Inc., President and CEO of Verizon Wireless, and Executive Vice President and Chief Operating Officer of Verizon Wireless. Before Verizon Wireless was formed, Mr. McAdam held executive positions with PrimeCo Personal Communications, AirTouch Communications and Pacific Bell. In the past five years, Mr. McAdam has also served as a member of the Verizon Wireless Board of Representatives.

QUALIFICATIONS

Mr. McAdam provides the Board with substantial and wide-ranging expertise in the telecommunications industry, developed during his pivotal role in the development of Verizon Wireless. As CEO of Verizon Communications Inc., he is able to provide the Board with in-depth knowledge of the Company's business, industry, challenges and opportunities.

Table of Contents

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**21**

**Donald T. Nicolaisen**

**BACKGROUND**

Mr. Nicolaisen served as Chief Accountant of the United States Securities and Exchange Commission (SEC) from 2003 to 2005. Prior to joining the SEC, he was a senior partner at the accounting firm PricewaterhouseCoopers. Mr. Nicolaisen began his career at the firm's predecessor, Price Waterhouse, in 1967, and held a wide range of management and leadership positions, including serving on the firm's U.S. and global boards and leading Price Waterhouse's national office for accounting and SEC services. Since 2006, Mr. Nicolaisen has served as a director of MGIC Investment Corporation, Morgan Stanley, and Zurich Insurance Group.

**QUALIFICATIONS**

Mr. Nicolaisen's long career in leadership positions in both the public and private sector provides the Board with substantial expertise in the areas of public accounting, risk management and corporate finance. This experience, combined with his director roles on the boards of other large, complex firms, provides the Board with additional capabilities in the areas of public policy and corporate governance.

Clarence Otis, Jr.

## BACKGROUND

Mr. Otis is the former Chairman and Chief Executive Officer of Darden Restaurants, Inc., the largest company-owned and operated full-service restaurant company in the world. He served as CEO of Darden Restaurants from 2004 to 2014 and as Chairman from 2005 to 2014. Since joining Darden in 1995 as Vice President and Treasurer, Mr. Otis served in a number of positions of responsibility, including Chief Financial Officer, Executive Vice President, and President of Smokey Bones Barbeque & Grill, a restaurant concept formerly owned and operated by Darden. Since 2010, Mr. Otis has served as a class B director of the Federal Reserve Bank of Atlanta. He has also served as a director of VF Corporation since 2004.

## QUALIFICATIONS

Mr. Otis provides the Board with valuable insight into consumer services, retail operations, financial oversight and risk management. His experience over his 20 years at Darden Restaurants provides him with important perspectives on operations, strategy and management of a complex organization and a large-scale workforce.

Verizon 2015 Proxy Statement

Table of Contents

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**22**

**Rodney E. Slater**

**BACKGROUND**

Mr. Slater is a Partner at the law firm Squire Patton Boggs LLP, practicing in the areas of transportation, infrastructure and public policy, a position he has held since 2001. Previously, Mr. Slater served as the U.S. Secretary of Transportation from 1997 to 2001 and as the Administrator of the Federal Highway Administration from 1993 to 1997. Mr. Slater has served as a director of Kansas City Southern since 2001 and Transurban Group since 2009. In the past five years, Mr. Slater has also served as a director of Delta Air Lines, Inc., ICx Technologies, Inc. and Atkins plc.

**QUALIFICATIONS**

Mr. Slater has substantial regulatory and public policy experience at the federal and state levels. Mr. Slater provides the Board with valuable insights on public policy issues and leadership on matters involving multiple stakeholders. He also provides the Board with perspectives on strategic partnerships and legal issues facing the Company.

Kathryn A. Tesija

## BACKGROUND

Ms. Tesija is Executive Vice President and Chief Merchandising and Supply Chain Officer of Target Corporation, the second largest discount retailer in the United States a position she has held since 2008. She is also a member of Target's executive committee. Since joining Target in 1986, Ms. Tesija has served in numerous positions of responsibility, including Director, Merchandise Planning and Senior Vice President, Hardlines Merchandising.

## QUALIFICATIONS

Ms. Tesija provides the Board with valuable large-scale global merchandising and supply chain experience, as well as operational perspectives and strategic planning expertise. Her current role as EVP and Chief Merchandising and Supply Chain Officer provides the Board with additional insights into the retail industry and consumer behavior.

Verizon 2015 Proxy Statement

Table of Contents

**ELECTION OF DIRECTORS | (Item 1 on Proxy Card)**

**23**

**Gregory D. Wasson**

**BACKGROUND**

Mr. Wasson is the former President and Chief Executive Officer of Walgreens Boots Alliance, Inc., the first global pharmacy-led health and wellbeing enterprise. From 2009 through 2014 he was Director, President and Chief Executive Officer of Walgreen Co. A registered pharmacist, he joined Walgreen in 1980 and served in a number of positions of responsibility, including President of Walgreens Health Initiatives, Senior Vice President, Executive Vice President, and President and Chief Operating Officer. Mr. Wasson also served as a director of AmerisourceBergen Corporation through January 2015.

**QUALIFICATIONS**

Mr. Wasson provides the Board with valuable global operational and management experience, as well as extensive knowledge of the retail and healthcare industries. His tenure as CEO of a large publicly-held company provides the Board with additional in-depth perspective in organizational management.

Verizon 2015 Proxy Statement

**Table of Contents****RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM | (Item 2 on P****24****RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC****ACCOUNTING FIRM (Item 2 on Proxy Card)**

The Audit Committee of the Board considered the performance and qualifications of Ernst & Young LLP, and has reappointed the independent registered public accounting firm to examine the financial statements of Verizon for the fiscal year 2015 and to examine the effectiveness of internal control over financial reporting. Ernst & Young has been retained as Verizon's Independent Registered Public Accounting Firm since 2000.

Verizon paid the following fees to Ernst & Young for services rendered during fiscal years 2014 and 2013:

	2014	2013
Audit fees	\$ 26.5 million	\$ 24.6 million
Audit-related fees	\$9.8 million	\$4.6 million
Tax fees	\$2.8 million	\$4.0 million
All other fees	\$0.5 million	\$1.1 million

Audit fees include the financial statement audit, the audit of the effectiveness of the Company's internal control over financial reporting required by the Sarbanes-Oxley Act of 2002, as well as financial statement audits required by statute for our foreign subsidiaries or by regulatory agencies in the United States. Audit-related fees primarily include audits of other subsidiaries, employee benefit plan audits, reviews of controls over services provided to customers, as well as other audit and due diligence procedures performed in connection with acquisitions or dispositions. Our audit fees and audit-related fees increased in 2014 due to the fact that we incurred \$7.5 million of fees related to the Company's acquisition of sole ownership of Verizon Wireless and the increased debt financing activity that occurred during and after the acquisition, as well as the Company's consideration of potential strategic transactions. Tax fees primarily consist of federal, state, local and international tax planning and compliance. All other fees primarily consist of support services to certain Verizon expatriate employees. The Committee considered, in consultation with management and the independent registered public accounting firm, whether the provision of these services is compatible with maintaining the independence of Ernst & Young.



The Committee is directly responsible for the appointment, compensation, retention and oversight of the independent registered public accounting firm retained to perform audit services. In order to assure continuing auditor independence, the Committee periodically considers whether there should be a regular rotation of the independent registered public accounting firm. The Committee ensures that the mandated rotation of the independent registered public accounting firm's personnel occurs routinely and is directly involved in the selection of Ernst & Young's lead engagement partner.

The Committee has established policies and procedures regarding pre-approval of services provided by the independent registered public accounting firm and is responsible for the audit fee negotiations associated with

Verizon 2015 Proxy Statement

---

**Table of Contents**

**RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING  
FIRM | (Item 2 on Proxy Card)**

25

the engagement of the independent registered public accounting firm. At the beginning of the fiscal year, the Committee pre-approves the engagement of the independent registered public accounting firm to provide audit services based on fee estimates. The Committee also pre-approves proposed audit-related services, tax services and other permissible services, based on specified project and service details, fee estimates, and aggregate fee limits for each service category. The Committee receives a report at each meeting on the status of services provided or to be provided by the independent registered public accounting firm and the related fees and all fees are approved.

The affirmative vote of a majority of the shares cast at the annual meeting is required to ratify the reappointment of Ernst & Young for the 2015 fiscal year. The Committee believes that the continued retention of Ernst & Young to serve as Verizon's independent registered public accounting firm is in the best interests of Verizon and its shareholders. If this appointment is not ratified by the shareholders, the Committee will reconsider its decision.

One or more representatives of Ernst & Young will be at the 2015 Annual Meeting of Shareholders. They will have an opportunity to make a statement and will be available to respond to appropriate questions.

Verizon 2015 Proxy Statement

**Table of Contents**

**ADVISORY VOTE TO APPROVE EXECUTIVE COMPENSATION | (Item 3 on Proxy Card)**

26

**ADVISORY VOTE TO APPROVE EXECUTIVE COMPENSATION (Item 3 on Proxy Card)**

In accordance with Section 14A of the Securities Exchange Act of 1934, we are seeking advisory shareholder approval of the compensation of our named executive officers as disclosed in the sections of this proxy statement titled Compensation Discussion and Analysis and Compensation Tables. Shareholders are being asked to approve the following non-binding resolution at the 2015 Annual Meeting of Shareholders:

Resolved, that the shareholders approve, on an advisory basis, the compensation of the named executive officers, as disclosed in the Company's Proxy Statement for the 2015 Annual Meeting of Shareholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the Compensation Tables and the related narrative discussion.

Shareholders have strongly supported the Company's executive compensation program since our first advisory vote on executive compensation in 2009, and the structure of the executive compensation program for 2014 that is described in this proxy statement did not materially change from the prior year. The Board recommends a vote FOR this resolution because it believes that our compensation policies and practices are effective in:

Encouraging strong short-term and long-term performance;

Aligning the executives' long-term interests with those of our shareholders; and

Retaining high-performing executives.

In the Compensation Discussion and Analysis and Compensation Tables beginning on page 28, we have provided a detailed description of our executive compensation programs, including the philosophy underpinning the programs, the elements of our programs and the compensation of our named executive officers. We encourage our shareholders to read these sections before deciding how to vote on this proposal.

This advisory resolution, commonly known as a “say-on-pay” resolution, is non-binding on the Board of Directors. Although non-binding, the Board and the Human Resources Committee will review and consider the voting results when evaluating our executive compensation program.

The Board has adopted a policy of providing for annual say-on-pay advisory votes. The next say-on-pay advisory vote will occur at the Company’s 2016 Annual Meeting of Shareholders.

Verizon 2015 Proxy Statement

Table of Contents

COMPENSATION COMMITTEE REPORT

27

COMPENSATION COMMITTEE REPORT

The Human Resources Committee has reviewed and discussed the Compensation Discussion and Analysis with management. Based on such review and discussions, the Committee recommended to the Board of Directors, and the Board has approved, the inclusion of the Compensation Discussion and Analysis in this proxy statement and the Company's Annual Report on Form 10-K.

Respectfully submitted,

The Human Resources Committee

*Clarence Otis, Jr., Chairperson*

*Richard Carrión*

*Melanie Healey*

*Gregory Wasson*

Dated: March 4, 2015

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Executive Summary**

**28**

**COMPENSATION DISCUSSION AND ANALYSIS**

The Human Resources Committee of the Board of Directors oversees the development and implementation of the total compensation program for Verizon's named executive officers. The CEO's compensation is determined by the independent members of the Board after receiving the Committee's recommendation, and references to the Committee in this section with respect to the CEO's compensation reflect that process.

**FOR 2014, VERIZON'S NAMED EXECUTIVE OFFICERS WERE:**

LOWELL C. MCADAM	Chairman and Chief Executive Officer
FRANCIS J. SHAMMO	Executive Vice President and Chief Financial Officer
DANIEL S. MEAD	Executive Vice President and President of Strategic Initiatives*
JOHN G. STRATTON	Executive Vice President and President of Operations*
RANDAL S. MILCH	Executive Vice President*

\* *Mr. Mead served as Executive Vice President and President and CEO Verizon Wireless until February 17, 2015. Mr. Stratton served as Executive Vice President and President Global Enterprise and Consumer Wireline until February 17, 2015. Mr. Milch served as Executive Vice President Public Policy and General Counsel until December 31, 2014.*

**Executive Summary**

2014 Company Performance: Verizon is the largest wireless company in America as measured by the number of wireless customers and total revenues. Our strategy is to build on the strength of our networks as platforms for future growth and innovation. To that end, in 2014 we focused on the growing areas of our business mobility, broadband, video and security. We also achieved a strategic milestone, obtaining sole ownership of Verizon Wireless, which will enable us to better leverage our assets and capabilities across our businesses going forward. With that acquisition, Verizon became the 10<sup>th</sup> largest company among the Related Dow Peers (defined below) in terms of market

capitalization. Our experienced management team delivered strong results in 2014 in an increasingly competitive environment through solid execution on our strategic initiatives and disciplined focus on our financial objectives.

*1 A reconciliation of non-GAAP measures to the most directly comparable GAAP measures can be found in Appendix A to this proxy statement.*

2014 Performance Payouts: Based on Verizon's financial performance in 2014, the 2014 short-term incentive award was paid at 95% of its targeted level, and based on Verizon's total shareholder return and free cash flow over the past three years, the performance stock units granted in connection with the 2012-2014 long-term incentive award vested at 79% of the targeted level.

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Executive Summary**

**29**

**KEY 2014 COMPENSATION ACTIONS**

Changes to salaries and incentive opportunities: Based on an analysis of market data, named executive officers received base salary increases. These base salary increases were designed, when considered in light of the executives' total compensation packages, to maintain the market competitiveness of each executive's total compensation opportunity, taking into account each executive's experience, tenure and job responsibilities following our acquisition of sole ownership of Verizon Wireless. In addition, to further emphasize performance-based incentive pay and compensate our executive officers at levels commensurate with Verizon's position in the market, Mr. McAdam's target annual long-term incentive opportunity, expressed as a percentage of base salary, was increased from 625% to 750%, and the target annual short-term incentive opportunity for the other named executive officers, expressed as a percentage of base salary, was increased from 110% to 150%.

Changes in short-term metrics: The Committee rebalanced the weightings of the financial metrics for the 2014 short-term incentive program. Consistent with Verizon's strategic plan, the Committee adjusted the weightings of the financial measures from 2013 to place a greater emphasis on free cash flow given the importance of cash generation and debt reduction following the acquisition of sole ownership of Verizon Wireless. In addition, it introduced a sustainability measure reflecting Verizon's commitment to reducing the environmental impact of our operations.

**HIGHLIGHTS OF EXECUTIVE COMPENSATION PROGRAM**

Our commitment to industry-leading compensation and governance practices is reflected in the design of our compensation program. Some of these elements include:

PAY FOR	Approximately 90% variable, incentive-based pay comprised of an annual cash
PERFORMANCE	incentive based on achieving pre-established performance goals and a long-term equity-based incentive award that has a three-year performance period



No guaranteed pension or supplemental retirement benefits since 2006

ROLE OF RELATED  
DOW

Same peer group (Related Dow Peers) is used to benchmark total compensation opportunity and evaluate long-term performance, providing consistency and transparency to shareholders

PEER GROUP

COMPENSATION  
AND

Compensation program is designed to encourage executives to appropriately balance risk and reward consistent with the Company's enterprise business risk management program

RISK MITIGATION

Clawback policy enables us to recapture and cancel incentive payments received by executives who engaged in financial misconduct

Anti-hedging policy applies to employees who receive equity-based incentive awards

SHAREHOLDER

Outreach program allows institutional shareholders to provide ongoing input on Verizon's executive compensation program and policies in addition to the feedback we receive from the annual say-on-pay vote

OUTREACH

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Peer Group Selection and the Role of Benchmarking**

**30**

**Peer Group Selection and the Role of Benchmarking**

The Committee believes that it is a best practice to use the same peer group to benchmark executive pay opportunities and to evaluate Verizon's relative stock performance under its long-term incentive plan. For these purposes, the Committee uses a single peer group that includes the 29 companies (other than Verizon) in the Dow Jones Industrial Average, plus Verizon's four largest industry competitors that are not included in the Dow Jones Industrial Average. These 33 companies are referred to as the Related Dow Peers. The Committee believes that this group of companies is appropriate for the dual purpose of benchmarking executive pay opportunities and evaluating relative stock performance under the long-term incentive plan because it is comprised of companies similar to us in market capitalization, net income, revenue and total employees that are included in an established and recognizable index, as well as Verizon's four other largest industry competitors. These companies represent Verizon's primary competitors for executive talent and investor dollars. Moreover, this peer group is self-adjusting so that changes in the companies included in the Dow Jones Industrial Average are also reflected in the Related Dow Peers over time. For this reason, the Committee believes that use of the Related Dow Peers provides a consistent measure of Verizon's performance and makes it easier for shareholders to understand, evaluate and monitor Verizon's compensation program.

The Committee evaluates whether the compensation opportunities for executives are appropriate and competitive by comparing each named executive officer's total compensation opportunity—which represents the sum of the executive's base salary and target award amounts under the short-term and long-term incentive plans—to the total compensation opportunities for executives in comparable positions at peer companies. The Committee references the 50<sup>th</sup> percentile of the Related Dow Peers when making this comparison, although the total compensation opportunity may be above or below the 50<sup>th</sup> percentile depending upon the tenure and overall level of responsibility of a particular executive. The Committee believes that this is an appropriate targeted level of total compensation opportunity because of Verizon's size relative to the Related Dow Peers. Actual total compensation may fall above or below the targeted opportunity based on annual and long-term performance results.

**RELATED DOW PEER INFORMATION**

The following chart shows the companies included in the Related Dow Peers for 2014 compensation purposes, their market capitalization as of December 31, 2014 as reported by Bloomberg, and net income attributable to the company, revenue and total number of employees as of each company's most recent fiscal year-end as reported in SEC filings.

Verizon 2015 Proxy Statement

Table of Contents**COMPENSATION DISCUSSION AND ANALYSIS | Peer Group Selection and the Role of Benchmarking****31**

## RELATED DOW PEER INFORMATION

	Market Capitalization	Net Income Attributable	Revenue	
Company	(\$ Millions)	the Company (\$ Millions)	(\$ Millions)	Total Employees
3M	105,299	4,956	31,821	89,800
American Express	96,266	5,885	35,999	54,000
AT&T	174,231	6,224	132,447	243,620
Boeing	92,667	5,446	90,762	165,500
Caterpillar	55,412	3,695	55,184	114,233
CenturyLink	22,589	772	18,031	45,000
Chevron	212,068	19,241	200,494	64,700
Cisco Systems	142,234	7,853	47,142	74,042
Coca-Cola	184,928	7,098	45,998	129,200
Comcast	149,264	8,380	68,775	139,000
Du Pont (E.I.)	66,986	3,625	34,723	63,000
Exxon Mobil	391,482	32,520	394,105	75,300
General Electric	253,766	15,233	148,589	305,000
Goldman Sachs Group	87,261	8,477	40,085	34,000
Home Depot	138,332	6,345	83,176	365,000
IBM	158,781	12,022	92,793	379,592
Intel	175,462	11,704	55,870	106,700
Johnson & Johnson	292,703	16,323	74,331	126,500
JPMorgan Chase	233,936	21,762	102,102	241,359
McDonald's	91,189	4,758	27,441	420,000
Merck	161,901	11,920	42,237	70,000
Microsoft	382,881	22,074	86,833	128,000
Nike	82,834	2,693	27,799	56,500
Pfizer	196,265	9,135	49,605	78,300

Procter & Gamble	246,136	11,643	83,062	118,000
Sprint Corporation	16,417	(1,860)	16,891	38,000
Time Warner Cable	42,652	2,031	22,812	54,800
Travelers	35,078	3,692	27,162	30,200
UnitedHealth Group	97,025	5,619	130,474	170,000
United Technologies	104,841	6,220	65,100	211,500
VISA Inc.	162,178	5,438	12,702	9,500
Wal-Mart	276,808	16,363	485,651	2,200,000
Walt Disney	159,719	7,501	48,813	180,000
Verizon	194,124	9,625	127,079	177,300

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | The Role of Say-on-Pay and Shareholder Outreach**

**32**

**The Role of Say-on-Pay and Shareholder Outreach**

In 2014, we engaged in discussions with institutional investors representing almost one quarter of our outstanding shares in connection with our semiannual shareholder outreach program. In these sessions, our investors continued to support our overall compensation philosophy and program, believing it to be well-structured and aligned with performance. Feedback from these investor discussions was provided to the Committee.

In addition, the Company provides its shareholders with the opportunity to cast an annual advisory vote on executive compensation a say-on-pay. At our Annual Meeting of Shareholders in May 2014, approximately 94% of the votes cast on the say-on-pay proposal were voted in favor of the proposal. The Committee believes that there is strong shareholder support for the Company's executive compensation programs based on the investor feedback from our outreach sessions, our say-on-pay vote at our 2014 Annual Meeting and the history of strong shareholder support in prior say-on-pay votes. As a result, the Committee continued to apply the same effective principles and philosophies applied in prior years (highlighted above and described more fully below) when making compensation decisions for 2014.

**Independent Compensation Consultant**

The Committee has retained Pearl Meyer & Partners as its compensation consultant (Consultant) based on its experience representing large corporations and its independence. More information regarding the Committee's determination of the Consultant's independence and the role and function of the Consultant may be found beginning on page 10.

**Compensation Objectives and Elements of Compensation**

**COMPENSATION OBJECTIVES**

Verizon's compensation program is designed to:

Align executives' and shareholders' interests through the use of performance-based compensation; and

Attract, retain and motivate high-performing executives.

To promote a performance-based culture that further links the interests of management and shareholders, the Committee has developed a compensation program that:

Focuses extensively on variable, performance-based compensation, with fixed compensation in the form of base salary constituting only approximately 10% of each executive's total compensation opportunity; and

Does not include guaranteed defined benefit pension and supplemental pension benefits.

Verizon 2015 Proxy Statement

**Table of Contents****COMPENSATION DISCUSSION AND ANALYSIS | Compensation Objectives and Elements of Compensation****33**

In establishing the mix of incentive pay used in the Company's pay-for-performance program, the Committee balances the importance of meeting the Company's short-term business goals with the need to create shareholder value over the longer term. To that end:

Long-term target compensation opportunities are more than two times the annual target compensation opportunities.

The Company's long-term incentive program features three-year performance cycles with awards that include performance stock units (PSUs) subject to both performance-based and time-based vesting requirements and, to encourage high-performing executives to remain with the Company, restricted stock units (RSUs) that vest based on the executive's continued employment through the end of the three-year performance cycle.

**ELEMENTS OF COMPENSATION**

The Committee determines the appropriate balance between fixed and variable pay elements, short- and long-term pay elements and cash and equity-based pay elements when setting total compensation at competitive levels.

<b>Pay Element</b>	<b>Characteristics</b>	<b>Primary Objective</b>
<b>BASE SALARY</b>	Annual fixed cash compensation	Attract and retain high-performing and experienced executives
<b>SHORT-TERM INCENTIVE (STI) OPPORTUNITY</b>	Annual variable cash compensation based on the achievement of annual performance measures	Incentivize executives to achieve challenging short-term performance goals
<b>LONG-TERM INCENTIVE (LTI) OPPORTUNITY</b>	Long-term variable equity awards granted annually as a combination of PSUs and RSUs	Align executives' interests with those of shareholders to grow long-term value and retain executives



The Committee references the 50<sup>th</sup> percentile of the Related Dow Peers to benchmark the total compensation opportunity of each of our named executive officers. While the Committee does not benchmark each element of a named executive officer's total compensation opportunity, it does review market data with respect to the mix of annual cash and long-term equity components for similarly situated executives among the Related Dow Peers.

### COMPENSATION MIX

The Committee has determined that a substantial majority of each named executive officer's total compensation opportunity should be variable and performance-based in order to emphasize a performance-based culture. Accordingly, for 2014, the Committee determined in its business judgment to allocate approximately 10% of each executive's total compensation opportunity in the form of base salary, approximately 20% in the form of short-term incentive, and approximately 70% in the form of long-term incentive.

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | 2014 Annual Base Salary**

**34**

The following chart illustrates the approximate allocation of the named executive officers' 2014 total compensation opportunity between variable, performance-based elements and fixed pay:

The named executive officers are also eligible to receive medical, disability and savings plan benefits that are generally provided to all management employees, as well as certain other benefits that are described under "Other Elements of the Total Compensation Program" beginning on page 43.

**2014 Annual Base Salary**

To determine an executive's base salary, the Committee, in consultation with the Consultant, reviews the pay practices of the Related Dow Peers for comparable positions and considers the executive's experience, tenure and the scope of the executive's responsibility, as well as internal pay equity. In particular, the Committee focuses on how base salary levels may impact the market competitiveness of an executive's total compensation opportunity. The Committee also discusses its assessment of the other named executive officers with the CEO. Based on its assessment, the Committee approved a base salary increase in 2014 of 6.7% for Mr. McAdam, 6.5% for Mr. Shammo, 5.6% for Mr. Mead, 10.3% for Mr. Stratton and 8.2% for Mr. Milch. These increases were designed, when considered in light of the executives' total compensation packages, to maintain the market competitiveness of each executive's total compensation opportunity, taking into account each executive's experience, tenure and job responsibilities following our acquisition of sole ownership of Verizon Wireless. The Committee determined the adjustments were appropriate to provide a total compensation opportunity that more closely approximates the 50<sup>th</sup> percentile for comparable executives within the Related Dow Peers, while maintaining a compensation mix with approximately 10% of each named executive officer's total compensation opportunity in the form of base salary.

**2014 Short-Term Incentive Compensation**

The Verizon Short-Term Incentive Plan (Short-Term Plan) motivates executives to achieve challenging short-term performance goals. Each year, the Committee establishes the potential value of the opportunities under the Short-Term Plan, as well as the performance targets required to achieve these opportunities.

Verizon 2015 Proxy Statement

Table of Contents**COMPENSATION DISCUSSION AND ANALYSIS | 2014 Short-Term Incentive Compensation****35**

The Committee sets the values of the Short-Term Plan award opportunities as a percentage of an executive's base salary based on the scope of the executive's responsibilities and on the competitive pay practices of the Related Dow Peers. These award opportunities are established at threshold, target and maximum levels. The Short-Term Plan award opportunities at the threshold, target and maximum levels for each of the named executive officers are shown in the Grants of Plan-Based Awards table on page 49.

The following table shows the 2014 Short-Term Plan target award opportunity for each of the named executive officers:

**2014 SHORT-TERM PLAN TARGET AWARD OPPORTUNITY**

<b>Named Executive Officer</b>	<b>As a Percentage of Base Salary</b>	<b>As a Dollar Value</b>
Mr. McAdam	250%	\$4,000,000
Mr. Shammo	150%	\$1,237,500
Mr. Mead	150%	\$1,425,000
Mr. Stratton	150%	\$1,200,000
Mr. Milch	150%	\$1,087,500

The 2014 target award opportunity for Mr. McAdam, expressed as a percentage of his base salary, did not increase from the target level established for his 2013 award opportunity. For our named executive officers other than the CEO, the 2014 target award opportunity was increased from 110% to 150% of their respective base salaries. The Committee determined that these adjustments were appropriate to provide a total compensation opportunity that more closely approximates the 50<sup>th</sup> percentile for comparable executives within the Related Dow Peers, while maintaining a compensation mix with each executive's target annual short-term incentive representing approximately 20% of the executive's total compensation opportunity. The extent to which the named executive officers earn the targeted Short-Term Plan award is based on Verizon's performance against measures established by the Committee at the beginning of the year.

## ANNUAL PERFORMANCE MEASURES

The Committee reviews and establishes the performance measures for the Short-Term Plan each year to help ensure that the program design appropriately motivates executives to achieve challenging financial and operational performance goals that are consistent with Verizon's strategic plan.

Verizon 2015 Proxy Statement

---

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | 2014 Short-Term Incentive Compensation**

**36**

In the first quarter of 2014, the Committee reviewed and approved the performance measures for the 2014 Short-Term Plan. Consistent with 2013, the Short-Term Plan award opportunities were based primarily on achieving specific goals under three Company-wide financial and operating performance measures – adjusted earnings per share (EPS), total revenue and free cash flow – which were selected to reflect the Company’s strategic goals of encouraging profitable operations, overall growth in the Company and efficient use of capital.

The 2014 performance measures, along with the weighting ascribed to each, are shown below as a percentage of the total Short-Term Plan award opportunity at target level performance.

Consistent with Verizon’s strategic plan, when the Committee approved the 2014 performance measures, it adjusted the weightings of the financial measures from 2013 to place a greater emphasis on free cash flow given the importance of cash generation and debt reduction following the acquisition of sole ownership of Verizon Wireless. In addition, it introduced a sustainability measure reflecting Verizon’s commitment to reducing the environmental impact of our operations. The Committee believes that these performance measures are appropriate to incentivize the Company’s executives to achieve outstanding short-term results and, at the same time, help build long-term value for shareholders. The 2014 measures are described in detail below.

**Adjusted EPS**

**TARGET RANGE: \$3.37 – \$3.46**

The Committee views adjusted EPS as an important indicator of Verizon's success in delivering shareholder value. The Committee assigns the greatest weight to adjusted EPS in determining awards under the Short-Term Plan because this measure is broadly used and recognized by investors as a key indicator of Verizon's ongoing operational performance and the Company's profitability. Adjusted EPS excludes non-operational items, including, but not limited to, impairments and gains and losses from divestitures, business combinations, changes in accounting principles, the net impact of pension and post-retirement benefit costs, extraordinary items and restructurings. As a result, adjusted EPS is not positively or negatively impacted from period to period by these types of items, so the Committee believes it better reflects the relative success of the Company's ongoing business.

Verizon 2015 Proxy Statement

Table of Contents

**COMPENSATION DISCUSSION AND ANALYSIS | 2014 Short-Term Incentive Compensation**

**37**

**Free Cash Flow**

**TARGET RANGE:** \$12.1 billion to \$13.7 billion

The Committee views consolidated free cash flow as another important indicator of Verizon's success in delivering shareholder value, because investors often use it in their equity valuation models. Free cash flow is calculated by subtracting capital expenditures from cash flow from operations. The Committee believes that this measure is meaningful because Verizon's businesses require significant capital investment, and the level of free cash flow reflects how efficiently the Company is managing its capital expenditures. Free cash flow also indicates the amount of cash that the Company has available to return to shareholders in the form of dividends and to reduce its outstanding debt. We consider both of these to be important goals, especially in light of the additional debt incurred when we acquired sole ownership of Verizon Wireless, as reflected by the heavier weighting of the free cash flow measure for 2014 as compared to 2013.

**Total Revenue**

**TARGET RANGE:** \$125.1 billion to \$126.5 billion

The Committee views consolidated total revenue as an important indicator of the Company's growth and success in managing its capital investments. This measure also reflects the level of penetration of Verizon's products and services in key markets.



## Diversity and Sustainability

**TARGETS:** Increase number of U.S. - based minority and female employees year-over-year; direct at least 9.2% of our overall supplier spending to minority- and female-owned firms; reduce our carbon intensity by at least 3% compared to the prior year

We are committed to promoting diversity among our employees and to recognizing and encouraging the contribution of diverse business partners to the Company's success. We are also committed to reducing the environmental impact of our operations. Our connected solutions empower industries and institutions to transform the way they work by making them more efficient, and creating smarter systems. We have incorporated many of these solutions in our own business to support our goal of cutting Verizon's carbon intensity—carbon emissions produced per terabyte of data flowing through our networks—in half by 2020. To reflect these important commitments, the 2014 performance measures include a new diversity and sustainability measure. For 2014, the Committee determined that the diversity target would be measured by the number of U.S. - based minority and female employees across the enterprise compared to the prior year and the levels of the Company's spending with minority- and female-owned or operated suppliers. The Committee also determined that the sustainability target would be measured by reduction in the carbon intensity of our operations compared to the prior year.

The achievement of the Short-Term Plan award opportunity with respect to each performance measure varies depending on the Committee's assessment of the Company's performance with respect to that measure.

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Long-Term Incentive Compensation**

**38**

In addition, no awards will be paid under the Short-Term Plan if Verizon's return on equity (ROE) for the plan year, based on adjusted net income, does not exceed 8%, even if some or all of the other performance measures are achieved. The Short-Term Plan provides for performance measures to be determined on an adjusted basis to mitigate the impact of certain types of events not contemplated at the time the performance measures were set, such as significant transactions, changes in legal or regulatory policy and other non-operational items.

**2014 COMPANY RESULTS COMPARED AGAINST ANNUAL PERFORMANCE MEASURES**

Verizon's 2014 results included:

ROE of 22.6%

An increase in the number of U.S. - based minority and female employees over the prior year (at target performance)

Adjusted EPS of \$3.35 (slightly below target range)

Over 9.2% of our overall supplier spending directed to minority- and female-owned firms (above target performance)

Consolidated total revenue of \$127.1 billion (slightly above target range)

Consolidated free cash flow of \$13.4 billion (at target range)

Reduction in carbon intensity of 3.4% (above target performance)

- 1 A reconciliation of non-GAAP measures to the most directly comparable GAAP measures may be found in Appendix A
- 2 Adjusted from reported ROE of 72.9% in accordance with the terms of the Short-Term Plan to address the impact of the transaction to acquire sole ownership of Verizon Wireless

2014 Short-Term Plan Award. After considering the level of performance with respect to each performance measure, and applying its business judgment based on an assessment of the level of achievement of each goal individually and collectively, the Committee determines the final Short-Term Plan award as a percentage of the target level for all executives. For 2014, this payout percentage was determined to be 95% of the target level. The following table shows the amount of the Short-Term Plan awards paid to each named executive officer.

Named Executive Officer	Actual 2014 Short-Term Plan Award (\$)
Mr. McAdam	3,800,000
Mr. Shammo	1,175,625
Mr. Mead	1,353,750
Mr. Stratton	1,140,000
Mr. Milch	1,033,125
Long-Term Incentive Compensation	

The Verizon Long-Term Incentive Plan (Long-Term Plan) is intended to align executives' and shareholders' interests and reward participants for creating long-term shareholder value. The Committee believes it is

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Long-Term Incentive Compensation**

**39**

important to establish a performance cycle under the Long-Term Plan that is longer than one year in order to meaningfully evaluate the performance of long-term strategies and the effect on value created for shareholders. Based on this consideration, and applying its business judgment, the Committee determined that a three-year performance cycle for the Long-Term Plan awards is appropriate.

For the past 10 years, the Long-Term Plan awards have consisted of PSUs and RSUs. The value of each PSU or RSU is equal to the value of one share of Verizon common stock. The Committee generally establishes an executive's Long-Term Plan award opportunity as a percentage of base salary and determines the number of PSUs and RSUs to be awarded based on the stock price on the grant date. The Committee assumes the executive will earn 100% of the PSUs and RSUs awarded for purposes of determining his or her total compensation opportunity. PSUs and RSUs accrue dividend equivalents that are deemed to be reinvested in PSUs and RSUs, respectively. The dividend equivalents are paid only to the extent that the PSUs or RSUs are earned.

The number of PSUs actually earned and paid is determined based upon Verizon's achievement of pre-established performance goals over the three-year performance cycle, with the ultimate value of each PSU based on the closing price of Verizon's common stock on the last trading day of the year in which the performance cycle ends. As a result, PSUs provide a strong incentive to executives to deliver value to Verizon's shareholders. RSUs vest and are paid based on the executive's continued employment with the Company through the end of the three-year award cycle, providing a retention incentive as well as a performance link as the value of the award depends on Verizon's stock price.

Consistent with the three prior award cycles, the 2014 PSUs are payable in cash and the 2014 RSUs are payable in Verizon shares. The Committee believes that paying PSUs in cash and RSUs in shares creates an appropriate balance between the potential shareholder dilution from paying awards in shares and cash flow considerations. Both types of awards further align executives' interests with those of Verizon's shareholders because an award's ultimate value is tied to the value of Verizon's common stock. In addition, paying the 2014 RSU awards in shares is consistent with Verizon's policy of requiring a significant level of equity ownership by our named executive officers.

Verizon 2015 Proxy Statement

**Table of Contents****COMPENSATION DISCUSSION AND ANALYSIS | Long-Term Incentive Compensation****40****2014 LONG-TERM PLAN AWARD OPPORTUNITIES**

Consistent with the 2012 and 2013 awards, each of the named executive officers received 60% of their 2014 Long-Term Plan award in the form of PSUs and 40% in the form of RSUs. Two-thirds of the PSUs are eligible to vest based on Verizon's relative total shareholder return (TSR) performance and one-third is eligible to vest based on Verizon's cumulative free cash flow. This approach encourages the retention of the Company's highly-qualified executive team and drives executives to deliver superior TSR performance and create free cash flow.

The Committee generally establishes an executive's Long-Term Plan target award opportunity as a percentage of the executive's base salary. The 2014 target award opportunities for each of the named executive officers are shown in the table below. For named executive officers other than Mr. McAdam, the target award opportunities increased over their 2013 target award opportunities solely as a result of their base salary increases identified above (i.e., their target award opportunities, expressed as a percentage of their base salaries, did not change.) For Mr. McAdam, the Committee increased the 2014 target award opportunity from 625% to 750% of Mr. McAdam's base salary to further emphasize performance-based incentive pay and to reflect Verizon's position in the market. The Committee sets the award levels to provide a total compensation opportunity that approximates the 50<sup>th</sup> percentile for comparable executives within the Related Dow Peers, while maintaining a compensation mix with each executive's target annual Long-Term Plan award opportunity representing approximately 70% of that executive's compensation opportunity. The target award opportunity for an executive is allocated between PSUs and RSUs as noted above, and the target award opportunity allocated to each type of award is converted into a target number of shares using the closing price of Verizon's common stock on the grant date.

The following table shows the target value of the 2014 Long-Term Plan awards granted to the named executive officers.

**2014 LONG-TERM PLAN TARGET AWARD OPPORTUNITY**

<b>Named Executive Officer</b>	<b>As a Percentage of Base Salary</b>	<b>As a Dollar Value</b>
Mr. McAdam	750%	\$12,000,000

Mr. Shammo	525%	\$4,331,250
Mr. Mead	525%	\$4,987,500
Mr. Stratton	525%	\$4,200,000
Mr. Milch	500%	\$3,625,000

#### TERMS OF 2014 PSU AWARDS

Two-thirds of the PSUs awarded are eligible to vest based on Verizon's TSR as compared to the TSR of the companies in the Related Dow Peers, as that group was constituted on the grant date of the award, over the 2014-2016 performance cycle.

#### Verizon 2015 Proxy Statement

Table of Contents

**COMPENSATION DISCUSSION AND ANALYSIS | Long-Term Incentive Compensation**

**41**

One-third of the PSUs awarded is eligible to vest based on Verizon's cumulative free cash flow over the 2014-2016 performance cycle compared to the performance targets established by the Committee at the beginning of the performance cycle.

**Total Shareholder Return Metric.** Two-thirds of the PSUs will vest based on relative TSR performance (TSR PSUs). The accompanying chart shows the percentage of the TSR PSUs awarded for the 2014-2016 performance cycle that will vest based on Verizon's relative TSR position compared with the companies in the Related Dow Peers as constituted on the date the award was granted. Verizon's TSR during the performance cycle must rank at least 15<sup>th</sup> the 58<sup>th</sup> percentile among the Related Dow Peers for 100% of the target number of TSR PSUs to vest, meaning Verizon must achieve above median TSR PSU performance for target vesting. The maximum number of TSR PSUs (200% of target) will vest only if Verizon's TSR during the three-year performance cycle ranks among the top four companies in the Related Dow Peers the 91<sup>st</sup> percentile or higher. If Verizon's TSR during the three-year performance cycle ranks below 25<sup>th</sup> approximately the 27<sup>th</sup> percentile of the companies in the Related Dow Peers, none of the TSR PSUs will vest.

**Free Cash Flow Metric.** One-third of the PSUs will vest based on Verizon's cumulative free cash flow (FCF PSUs). The percentage of the FCF PSUs awarded for the 2014-2016 performance cycle that will vest is based on the extent to which Verizon's cumulative FCF over the performance cycle meets or exceeds the cumulative FCF performance levels set by the Committee at the beginning of the performance cycle. FCF is calculated by subtracting capital



expenditures from cash flow from operations, and is subject to adjustment to eliminate the financial impact of significant transactions, changes in legal or regulatory policy and other extraordinary items.

The cumulative FCF target for the 2014-2016 performance cycle was set at a level that the Committee believes may be challenging in light of the business environment, but attainable. The number of FCF PSUs that will vest ranges from 0% if actual performance is below the threshold level to 200% if actual performance is at or above the maximum cumulative FCF level. The number of FCF PSUs that will vest in between the threshold and maximum performance levels will be determined by linear interpolation between vesting percentage levels.

Verizon 2015 Proxy Statement

Table of Contents

## COMPENSATION DISCUSSION AND ANALYSIS | Long-Term Incentive Compensation

42

## 2012 PSU AWARDS EARNED IN 2014

With respect to the PSUs awarded in 2012, the Committee determined the number of PSUs that vested for a participant based on the level of achievement of two performance metrics over the three-year performance cycle:

Two-thirds of the PSUs awarded were eligible to vest based on Verizon's TSR ranking for the 2012-2014 performance cycle relative to the Related Dow Peers as constituted on the date the award was granted.

One-third of the PSUs awarded was eligible to vest based on Verizon's cumulative free cash flow over the 2012-2014 performance cycle compared to the performance targets set by the Committee at the beginning of the three-year cycle.

**2012 TSR PSUs.** The percentage of TSR PSUs awarded for the 2012-2014 performance cycle that would vest at each different level of Verizon's relative TSR positioning compared with the companies in the applicable Related Dow Peers was identical to the percentage at each performance level for the 2014-2016 grant shown on the prior page.

Over the three-year performance cycle ending December 31, 2014, Verizon's TSR ranked 2<sup>nd</sup> among the Related Dow Peers, which was below the median of the group, resulting in a vesting percentage of 53%.

**2012 FCF PSUs.** The following shows the percentage of FCF PSUs awarded for the 2012-2014 performance cycle that would vest based on Verizon's cumulative free cash flow over the 2012-2014 performance cycle at different performance levels:

Verizon's Cumulative Free Cash Flow (in billions)	Percentage of Awarded FCF PSUs that Vest <sup>1</sup>
Greater than \$61.0	200%
\$57.0	150%

\$53.0	100%
\$44.0	50%
Less than \$44.0	0%

*1 For achievement between the stated percentages, vesting is determined by linear interpolation.*

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Other Elements of the Total Compensation Program**

**43**

At the time the award was granted, the Committee provided for free cash flow to be determined on an adjusted basis to preserve the incentives intended at the time the award was granted and to mitigate the impact of certain types of events not contemplated by our 2012-2014 financial plan, such as significant transactions, changes in legal or regulatory policy and other non-operational items. In accordance with this adjustment methodology, the Committee determined that Verizon's cumulative free cash flow over the performance period was \$55.5 billion, which resulted in a vesting percentage of 132%. The adjustments made to free cash flow in reaching this determination, all of which were required as a result of the transaction to acquire sole ownership of Verizon Wireless—a transaction not contemplated when the FCF PSU targets were set—are set forth in Appendix A. The adjustments reflect the cumulative impact of a net increase in interest expense arising from the additional debt incurred to fund the transaction; an increase in taxes paid by the Company due to the fact that after the transaction, the Company was required to include 100% of the income of Verizon Wireless in its gross income; and decreased cash flows from dividends as a result of the sale of the Company's interest in Vodafone Omnitel.

The Committee noted that after acquiring sole ownership of Verizon Wireless, and after paying dividends on the shares issued in the transaction, the Company had access to more cash to return to shareholders or reduce debt than it did prior to the transaction, even though free cash flow, as defined for purposes of the Long-Term Plan, was reduced by the transaction.

**2014 PSU Payout.** As a result of these achievements, in the first quarter of 2015 the Committee approved a payment to all participants, including the named executive officers, of 79% of the PSUs awarded for the 2012 - 2014 performance cycle, which represents the weighted average of the two vesting percentages described above, plus dividend equivalents credited on those vested PSUs.

**Other Elements of the Total Compensation Program**

The Company also provides the named executive officers with limited additional benefits as generally described below. None of the named executive officers is eligible for any tax gross-up payment in connection with any of these benefits, including with respect to excise tax liability arising from any Internal Revenue Code Section 280G excess parachute payments.

**PERSONAL BENEFITS**

**Transportation.** The Company provides limited aircraft and ground transportation benefits to enhance the safety and security of certain named executive officers. These transportation benefits also serve business purposes, such as allowing the executive to attend to confidential business matters while in transit.

**Executive Life Insurance.** The Company offers the named executive officers and other executives the opportunity to participate in an executive life insurance program in lieu of participating in the Company's basic and supplemental life insurance programs. The executives who elect to participate in the executive life insurance program own the life insurance policy, and the Company provides an annual cash payment to the executives to defray a portion of the annual premiums.

**Financial Planning.** The Company provides a voluntary Company-sponsored financial planning benefit program for the named executive officers and other executives.

For additional information on these benefits, see footnote 4 to the Summary Compensation Table on page 48.

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Other Elements of the Total Compensation Program**

**44**

**RETIREMENT BENEFITS**

In 2006, the Committee determined that guaranteed pay in the form of pension and supplemental executive retirement benefits was not consistent with the Company's pay-for-performance culture. Accordingly, effective June 30, 2006, Verizon froze all future pension accruals under its management tax-qualified and supplemental defined benefit retirement plans. These legacy retirement benefits that were previously provided to certain named executive officers are described in more detail under the section titled "Pension Plans" beginning on page 51.

During 2014, all of Verizon's named executive officers were eligible to participate in the Company's tax-qualified and nonqualified retirement savings plans. These plans are described in the section titled "Defined Contribution Savings Plans" beginning on page 54.

**SEVERANCE AND CHANGE IN CONTROL BENEFITS**

The Committee believes that maintaining a competitive level of separation benefits is appropriate as part of an overall program designed to attract, retain and motivate the highest-quality management team. However, the Committee does not believe that named executive officers should be entitled to receive cash severance benefits merely because a change in control occurs. Therefore, the payment of cash severance benefits is triggered only by an actual or constructive termination of employment.

The Company was not a party to any employment agreement with any of the named executive officers in 2014. All senior managers of the Company (including all named executive officers except Mr. McAdam) are eligible to participate in the Verizon Senior Manager Severance Plan, which provides certain separation benefits to participants whose employment is involuntarily terminated without cause. Mr. McAdam is not eligible to participate in the Senior Manager Severance Plan and is not eligible for cash severance benefits upon a termination.

The Senior Manager Severance Plan is generally consistent with the terms and conditions of Verizon's broad-based severance plan for management employees other than senior managers. Under the Senior Manager Severance Plan, if a participant has been involuntarily terminated without cause (or, in the case of a named executive officer, if the independent members of the Board determine that there has been a qualifying separation), the participant is eligible to receive a lump-sum cash separation payment equal to a multiple of his or her base salary plus target short-term incentive opportunity, along with continuing medical coverage for the applicable severance period. To the extent that

a senior manager is eligible for severance benefits under any other arrangement, that person is not eligible for any duplicative benefits under the severance plan. The plan does not provide for any severance benefits based upon a change in control of the Company.

Under the plan, the named executive officers (other than Mr. McAdam) are eligible to receive a cash separation payment equal to two times the sum of their base salary and target short-term incentive opportunity. Other senior manager participants are eligible to receive a cash separation payment based on a formula equal to between 0.75 and two times the sum of their base salary and target short-term incentive opportunity, depending on their position at the time of separation. To be eligible for any severance benefits, participants must execute a release of claims against Verizon in the form satisfactory to Verizon and agree not to compete or interfere with any Verizon business for a period of one year after their separation.

Verizon 2015 Proxy Statement

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Selected Compensation Policies**

**45**

Consistent with the Committee's belief that named executive officers should not be entitled to receive cash severance benefits merely because a change in control occurs, the Long-Term Plan does not allow single trigger accelerated vesting and payment of outstanding awards in connection with a change in control. The Long-Term Plan requires a double trigger specifically, if, in the 12 months following a change in control the participant's employment is terminated without cause, all then-unvested PSUs will fully vest at the target level performance, all then-unvested RSUs will fully vest and PSUs and RSUs (including accrued dividend equivalents) will become payable on the regularly scheduled payment date after the end of the applicable award cycle.

**Selected Compensation Policies**

**STOCK OWNERSHIP GUIDELINES**

To further align the interests of Verizon's management with those of its shareholders, the Committee has approved guidelines that require each named executive officer and other executives to maintain certain stock ownership levels.

The CEO is required to maintain share ownership equal to at least seven times base salary.

Other named executive officers are required to maintain share ownership equal to at least four times base salary.

Executives are also prohibited from short-selling or engaging in any financial activity that would allow them to benefit from a decline in Verizon's stock price.

In determining whether an executive meets the required ownership level, the calculation includes any shares held by the executive directly or through a broker, shares held through the Verizon tax-qualified savings plan or the Verizon nonqualified savings plan and other deferred compensation plans and arrangements that are valued by reference to Verizon's stock. The calculation does not include any unvested PSUs or RSUs. Each of the named executive officers is in compliance with the stock ownership guidelines. In addition, none of the named executive officers engaged in any pledging transaction with respect to shares of Verizon's stock.



## RECOVERY OF INCENTIVE PAYMENTS

The Committee believes that it is appropriate for the Company's compensation plans and agreements to provide for the termination or repayment of certain incentive awards and payments if an executive engages in certain fraudulent or other inappropriate conduct. Accordingly, the Committee has adopted a policy that enables the Company to claw back and cancel certain incentive payments received by an executive who has engaged in financial misconduct. The Committee reviews this policy from time to time and will refine the current policy to take into account any changes in applicable law.

## SHAREHOLDER APPROVAL OF CERTAIN SEVERANCE ARRANGEMENTS

The Committee has a policy of seeking shareholder approval or ratification of any new employment or severance agreement with an executive officer that provides for a total cash value severance payment

Verizon 2015 Proxy Statement

---

**Table of Contents**

**COMPENSATION DISCUSSION AND ANALYSIS | Tax and Accounting Considerations**

**46**

exceeding 2.99 times the sum of the executive's base salary plus Short-Term Plan target opportunity. The policy defines severance pay broadly to include payments for any consulting services, payments to secure a non-compete agreement, payments to settle any litigation or claim, payments to offset tax liabilities, payments or benefits that are not generally available to similarly situated management employees and payments in excess of, or outside, the terms of a Company plan or policy.

**Tax and Accounting Considerations**

Federal income tax law generally prohibits a publicly-held company from deducting compensation paid to a named executive officer (other than a chief financial officer) that exceeds \$1 million during the tax year unless it is based upon attaining pre-established performance measures that are set by the company's compensation committee under a plan approved by the company's shareholders. The Committee has the flexibility to take any compensation-related actions that it determines are in the best interests of the Company and its shareholders, including determining when to request shareholder approval of the Verizon incentive plans and when to award compensation that may not qualify for a tax deduction. Compensation paid to the named executive officers under the Short-Term Plan, as well as the PSUs awarded under the Long-Term Plan, are generally intended to meet the performance-based exception for deductibility under the tax laws. However, these rules impose a number of requirements and are subject to change from time to time, sometimes with retroactive effect. There can be no assurance that any compensation will in fact be deductible.

The Committee also considers the effect of certain accounting rules that apply to the various aspects of the compensation program for our named executive officers. The Committee reviews potential accounting effects in determining whether its compensation actions are in the best interests of the Company and its shareholders. The Committee has been advised by management that the impact of the variable accounting treatment required for long-term incentive awards payable in cash (as opposed to fixed accounting treatment for awards that are payable in shares) will depend on future stock performance.

Table of Contents

## COMPENSATION TABLES | Summary Compensation

47

## COMPENSATION TABLES

## Summary Compensation

The following table provides information about the compensation paid to each of our named executive officers in 2012, 2013 and 2014.

## SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary		Stock Awards	Option Awards	Incentive Plan	Non-Equity Compensation <sup>2</sup>	Change in Pension Value and Nonqualified Deferred Compensation <sup>3</sup>	All Other Compensation <sup>4</sup>	Total
		(\$)	(\$)					(\$)		
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	
LOWELL MCADAM	2014	1,580,769	0	12,000,052	0	3,800,000	75,647	850,041	18,306,509	
		1,480,769	0	9,375,077	0			780,874		
Chairman and Chief	2013	1,400,000	0	8,750,055	0	4,125,000	64,886	535,577	15,826,606	
									14,049,100	
Executive Officer	2012					3,150,000	213,468			
FRANCIS SHAMMO						1,175,625	12,491		6,498,751	

Edgar Filing: VERIZON COMMUNICATIONS INC - Form DEF 14A

<i>Executive Vice President</i>	2014	815,385	0	4,331,294	0	937,750	10,475	163,956	5,941,061
	2013	760,577	0	4,068,783	0			163,476	5,214,925
	2012	698,077	0	3,675,003	0	693,000	9,004	139,841	
<i>and Chief Financial Officer</i>									
<b>DANIEL MEAD</b>	2014	940,385	0	4,987,527	0	1,353,750	160,485	236,157	7,678,304
	2013	880,769	0	4,725,020	0			286,634	
<i>Executive Vice President</i>	2012	794,231	0	4,200,026	0	1,089,000	199,644	225,253	7,181,067
						792,000	388,096		6,399,606
<i>and President of Strategic Initiatives*</i>									
<b>JOHN STRATTON</b>	2014	785,577	0	4,200,028	0	1,140,000	30,023	188,530	6,344,158
	2013	715,385	0	3,806,297	0			139,433	
<i>Executive Vice President</i>	2012	673,558	0	3,543,796	0	877,250	37,128	143,629	5,575,493
						668,250	31,776		5,061,009
<i>and President of Operations*</i>									
<b>RANDAL MILCH</b>	2014	714,423	0	3,625,034	0	1,033,125	78,798	168,948	5,620,328
	2013	666,154	0	3,350,006	0			129,710	
<i>Executive Vice President*</i>	2012	648,077	0	3,250,020	0	810,700	73,527	125,949	5,030,097
						643,500	58,366		4,725,912

\* Mr. Mead served as Executive Vice President and President and CEO Verizon Wireless until February 17, 2015. Mr. Stratton served as Executive Vice President Global Enterprise and Consumer Wireline until February 17, 2015. Mr. Milch served as Executive Vice President Public Policy and General Counsel until December 31, 2014.

1 The amounts in this column reflect the grant date fair value of the PSUs and RSUs computed in accordance with FASB ASC Topic 718 based on the closing price of Verizon's common stock on the grant date. The grant date fair value of PSUs granted to the named executive officers in the designated year as part of Verizon's annual long-term incentive award program has been determined based on the vesting of 100% of the nominal PSUs awarded, which is the performance threshold the Company believed was most likely to be achieved under the grants on the grant date. The following table reflects the grant date fair value of these PSUs, as well as the maximum grant date fair value of these awards based on the closing price of Verizon's common stock on the grant date if, due to the Company's performance during the applicable performance cycle, the PSUs vested at their maximum level:

Name	Grant Date Fair Value of PSUs			Maximum Value of PSUs		
	2012(\$)	2013(\$)	2014(\$)	2012(\$)	2013(\$)	2014(\$)
Mr. McAdam	5,250,033	5,625,037	7,200,041	10,500,066	11,250,074	14,400,082
Mr. Shammo	2,205,002	2,441,260	2,598,767	4,410,004	4,882,520	5,197,534
Mr. Mead	2,520,008	2,835,012	2,992,516	5,040,016	5,670,024	5,985,032
Mr. Stratton	2,126,270	2,283,759	2,520,026	4,252,540	4,567,518	5,040,052
Mr. Milch	1,950,012	2,010,004	2,175,030	3,900,024	4,020,008	4,350,060

2 The amounts in this column for 2014 reflect the 2014 Short-Term Plan award paid to the named executive officers in February 2015 as described beginning on page 34.

Verizon 2015 Proxy Statement

**Table of Contents****COMPENSATION TABLES | Summary Compensation****48**

3 The amounts in this column for 2014 for Messrs. McAdam and Milch reflect the sum of the change in the actuarial present value of the accumulated benefit under the defined benefit plans and the above-market earnings on amounts held in nonqualified deferred compensation plans as follows: \$29,965 and \$45,682 for Mr. McAdam, and \$26,109 and \$52,689 for Mr. Milch. Messrs. Shammo and Stratton are not eligible for pension benefits, so amounts shown in this column reflect only above-market earnings for these executives. For 2014 there was a reduction in pension value for Mr. Mead of \$32,456 based on the applicable calculation formula. In accordance with SEC rules, because the aggregate change in the actuarial present value of the accumulated benefit under the defined benefit plans was a negative number for 2014, the amount shown in this column for 2014 for Mr. Mead reflects only above-market earnings. Verizon's defined benefit plans were frozen as of June 30, 2006, and Verizon stopped all future benefit accruals under these plans as of that date. All accruals under the Verizon Wireless pension plan were frozen as of December 31, 2006.

4 The following table provides the detail for 2014 compensation reported in the All Other Compensation column:

Name	Personal	Company Contributions		Company Contributions		All Other Compensation	
	Use of Company Aircraft <sup>a</sup>	Use of Company Vehicle <sup>b</sup>	Qualified Savings Plan (\$)	Nonqualified Deferral Plan (\$)	Life Insurance Benefit <sup>c</sup> (\$)	Other <sup>d</sup> (\$)	Total (\$)
Mr. McAdam	141,123	4,051	23,862	460,986	220,019	0	850,041
Mr. Shammo	0	0	15,712	101,117	37,127	10,000	163,956
Mr. Mead	0	0	23,862	150,218	43,645	18,432	236,157
Mr. Stratton	2,017	0	23,862	119,217	33,434	10,000	188,530
Mr. Milch	0	0	23,862	108,569	26,517	10,000	168,948

a The aggregate incremental cost of the personal use of a Company aircraft is determined by multiplying the total 2014 personal flight hours by the incremental aircraft cost per hour. The incremental aircraft cost per hour is derived by adding the annual aircraft maintenance costs, fuel costs, aircraft trip expenses and crew trip expenses, and then dividing by the total annual flight hours.

- b The aggregate incremental cost of the personal use of a Company vehicle is determined by (i) calculating the incremental vehicle cost per mile by dividing the annual lease and fuel costs by the total annual miles; (ii) multiplying the total 2014 personal miles by the incremental vehicle cost per mile; and (iii) adding the incremental driver cost (the 2014 driver hours for personal use multiplied by the driver's hourly rate).
- c Executive life insurance is available to executives on a voluntary basis. Executives who choose to participate in this program are excluded from the basic and supplemental life insurance programs that Verizon provides to management employees. The executive owns the insurance policy and is responsible for paying the premiums. However, Verizon pays each executive an amount, shown in this column, which is equal to a portion of the premium. Executives who choose not to participate in the executive life insurance plan do not receive that payment. For all named executive officers, the executive life insurance policy provides a death benefit equal to two times the sum of the executive's base salary plus his short-term incentive opportunity at 67% of target level if the executive dies before a designated date. For Messrs. McAdam, Shammo, Mead and Stratton, this date is the latest of the participant's retirement date, the date on which the participant reaches age 60 or the fifth anniversary of plan participation. For Mr. Milch, this date is the earlier of five years post-retirement or the date on which he reaches age 65.
- d This column represents the total amount of other perquisites and personal benefits provided. These other benefits consist of: (i) for Mr. Mead, financial planning services and personal travel; and (ii) for Messrs. Shammo, Stratton and Milch, financial planning services. The Company provides each of the named executive officers who elect to participate in the financial planning program with a financial planning benefit equal to the Company's payment for the services, up to \$10,000. The aggregate incremental cost of personal travel for Mr. Mead is equal to the direct expense related to his spouse's attendance at a business event at the request of the Company. These expenses include lodging, ground transportation, meals and other travel-related items.

Verizon 2015 Proxy Statement

Table of Contents

## COMPENSATION TABLES | Plan-Based Awards

49

## Plan-Based Awards

The following table provides information about the 2014 awards granted under the Short-Term Plan and the Long-Term Plan to each named executive officer.

## GRANTS OF PLAN-BASED AWARDS

Type of Award <sup>1</sup>	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards <sup>2</sup>			Estimated Future Payouts Under Equity Incentive Plan Awards <sup>3</sup>			All Other Stock Awards: Number of Shares of Stock or Units <sup>4</sup>	All Other Option Awards: Number of Securities Underlying Options	Exercise or Base Price of Option Awards (\$/Sh)	Grant Fair Value of Award
		Threshold	Target	Maximum	Threshold	Target	Maximum	(#)	(#)	(k)	
	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	
m STP		2,000,000	4,000,000	6,000,000							
PSU	3/7/2014				48,866	152,705	305,410				7,200
RSU	3/7/2014							101,803			4,800
o STP		618,750	1,237,500	1,856,250							
PSU	3/7/2014				17,637	55,117	110,234				2,500
RSU	3/7/2014							36,745			1,700
ad STP		712,500	1,425,000	2,137,500							



PSU	3/7/2014				20,310	63,468	126,936		2,9
RSU	3/7/2014							42,312	1,9
STP		600,000	1,200,000	1,800,000					
PSU	3/7/2014				17,103	53,447	106,894		2,5
RSU	3/7/2014							35,631	1,6
ch STP		543,750	1,087,500	1,631,250					
PSU	3/7/2014				14,762	46,130	92,260		2,1
RSU	3/7/2014							30,753	1,4

- 1 These awards are described in the Compensation Discussion and Analysis beginning on page 28.
- 2 The actual amount awarded in 2014 was paid in February 2015 and is shown in column (g) of the Summary Compensation Table on page 47.
- 3 These columns reflect the potential payout range of PSU awards granted in 2014 to our named executive officers in accordance with the Company's annual long-term incentive award program, as described beginning on page 40. At the conclusion of the three-year performance cycle, payouts can range from 0% to 200% of the target number of units awarded based on Verizon's relative TSR position as compared with the Related Dow Peers and Verizon's cumulative free cash flow over the three-year performance cycle as described in more detail beginning on page 40. PSUs and the applicable dividend equivalents are paid only and to the extent that the applicable performance criteria for the award are achieved at the end of the award cycle. When dividends are distributed to shareholders, dividend equivalents are credited on the PSU awards in an amount equal to the dollar amount of dividends on the total number of PSUs credited as of the dividend distribution date and divided by the fair market value of the Company's common stock on that date.
- 4 This column reflects the RSU awards granted in 2014 to the named executive officers in accordance with the Company's annual long-term incentive award program. When dividends are distributed to shareholders, dividend equivalents are credited on the RSU awards in an amount equal to the dollar amount of dividends on the total number of RSUs credited as of the dividend distribution date and divided by the fair market value of the Company's common stock on that date.
- 5 This column reflects the grant date fair value of each equity award computed in accordance with FASB ASC Topic 718 based on the closing price of Verizon's common stock on the grant date. For PSUs, the grant date fair value has been determined based on the vesting of 100% of the nominal PSUs awarded, which is the performance threshold the Company believes is the most likely to be achieved under the grants.

Table of Contents

## COMPENSATION TABLES | Plan-Based Awards

50

## OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

Name	Option Awards						Stock Awards				
							Equity Incentive Plan Awards:		Equity Incentive Plan Awards:		
							Number of		Market or Payout Value		
							Shares or Units of Stock That		Shares, Units or Rights That		
							Have Not Vested <sup>1,2</sup> (#)		Have Not Vested <sup>1,3</sup> (\$)		
							Have Not Vested <sup>1,4</sup> (#)		Have Not Vested <sup>1,5</sup> (\$)		
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	Grant Date	
Mr. McAdam	0	0	0	0	0	96,906	4,533,263	452,225	21,155,086	8/1/2011	
						84,232	3,940,373	32,850	1,536,723	3/8/2013	
						105,176	4,920,133	107,280	5,018,558	3/7/2014	
Mr. Shammo	0	0	0	0	0	36,557	1,710,136	14,257	666,942	3/8/2013	
						37,963	1,775,909	38,721	1,811,368	3/7/2014	
Mr. Mead	0	0	0	0	0	42,453	1,985,951	16,557	774,536	3/8/2013	
						43,714	2,044,941	44,588	2,085,827	3/7/2014	
Mr. Stratton	0	0	0	0	0	34,199	1,599,829	13,337	623,905	3/8/2013	
						36,812	1,722,065	37,548	1,756,495	3/7/2014	

Mr. Milch	0	0	0	0	0	30,099	1,408,031	11,738	549,104	3/8/2013
						31,772	1,486,294	32,408	1,516,046	3/7/2014

- 1 In 2011, Mr. McAdam received a special equity award in connection with his appointment as CEO, with 70% of the award opportunity in the form of PSUs and 30% in the form of RSUs, which may become payable after the completion of the five-year performance cycle ending July 31, 2016, provided that Mr. McAdam remains continuously employed, subject to the terms of the award agreements. The award will be settled in shares of Verizon common stock, and Mr. McAdam will be required to hold any shares he receives for at least two years following the vesting date unless he dies or becomes disabled.
- 2 The annual 2013 and 2014 RSU awards vest on December 31, 2015 and December 31, 2016, respectively. Mr. McAdam's 2011 special RSU award vests on July 31, 2016. RSUs accrue quarterly dividends that are reinvested into the participant's account as additional RSUs and will be included in the final RSU payment if the awards vest. This column includes dividend equivalent units that have accrued through December 31, 2014.

Description		Filed with this Form 10-K	Incorporated by Reference Form	Filing Date	Exhibit No.
3.1	Articles of Organization and amendments thereto		10-K	December 26, 2007	3.1
3.2	By-laws, as amended December 13, 2012		10-K	December 20, 2012	3.1
10.1	Form of Employee Invention and Non-Disclosure Agreement		10-K	November 22, 1996	10.3
10.2	CSPI Supplemental Retirement Income Plan		10-K	December 29, 2008	10.2
10.3*	2007 Stock Incentive Plan		DEF 14A	March 30, 2007	B
10.4*	2014 Variable Compensation (Executive Bonus) and Base Programs dated November 12, 2013		10-K	December 23, 2014	10.10
10.5*	Death Benefit and Retirement Benefit Agreement between the Company and Victor Dellovo dated September 13, 2013		10-K	December 24, 2013	10.11
10.6*	Form of Change of Control Agreement with Gary W. Levine and William E. Bent Jr. each dated January 11, 2008		10-K	December 22, 2009	10.11
10.7*	2014 Employee Stock Purchase Plan		DEF 14A	January 6, 2014	A
10.8*	2015 Stock Incentive Plan		DEF 14A	January 5, 2015	A
10.9	2015 Lowell, MA Lease		10-K	December 24, 2015	10.21
10.10	2015 Deerfield Beach, FL Lease		10-K	December 24, 2015	10.20

<u>21.1</u>	Subsidiaries	X
<u>23.1</u>	Consent of RSM LLP, Independent Registered Public Accounting Firm	X
<u>31.1</u>	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X
<u>31.2</u>	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X
<u>32.1</u>	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X
101.INS	XBRL Instance	
101.SCH	XBRL Taxonomy Schema	
101.CAL	XBRL Taxonomy Extension Calculation	
101.DEF	XBRL Taxonomy Extension Definition	
101.LAB	XBRL Taxonomy Extension Labels	
101.PRE	XBRL Taxonomy Extension Presentation	

\*Management contract or compensatory plan.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CSP INC.

By: /s/ Victor  
Dellovo  
Victor  
Dellovo  
Chief  
Executive  
Officer  
and  
President

Date: December 22, 2017

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Victor Dellovo Victor Dellovo	Chief Executive Officer, President and Director	December 22, 2017
/s/ Gary W. Levine Gary W. Levine	Chief Financial Officer (Principal Financial Officer)	December 22, 2017
/s/ Mike Newbanks Mike Newbanks	Vice President of Finance (Chief Accounting Officer)	December 22, 2017
/s/ C. Shelton James C. Shelton James	Director	December 22, 2017
/s/ Raymond Charles Blackmon Raymond Charles Blackmon	Director	December 22, 2017
/s/ Marilyn T. Smith Marilyn T. Smith	Director	December 22, 2017
/s/ Izzy Azeri Izzy Azeri	Director	December 22, 2017

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders  
CSP Inc. and Subsidiaries  
Lowell, MA

We have audited the accompanying consolidated balance sheets of CSP Inc. and Subsidiaries (the “Company”) as of September 30, 2017 and 2016, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of September 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ RSM US LLP

Boston, Massachusetts  
December 22, 2017

CSP INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Amounts in thousands, except par value)

	September 30, 2017	September 30, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 13,885	\$ 13,103
Accounts receivable, net of allowances of \$261 and \$240	27,630	18,997
Unbilled accounts receivable	772	567
Inventories	5,971	5,580
Deferred costs	929	635
Deferred income taxes	1,393	1,331
Other current assets	1,139	1,586
Total current assets	51,719	41,799
Property, equipment and improvements, net	1,508	1,680
Other assets:		
Intangibles, net	167	287
Deferred costs	609	18
Deferred income taxes	1,434	1,723
Cash surrender value of life insurance	3,300	3,015
Other assets	191	185
Total other assets	5,701	5,228
Total assets	\$ 58,928	\$ 48,707
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 18,845	\$ 11,932
Deferred revenue	6,202	4,704
Pension and retirement plans	534	581
Income taxes payable	442	166
Total current liabilities	26,023	17,383
Pension and retirement plans	11,818	13,441
Other long term liabilities	86	228
Total liabilities	37,927	31,052
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$.01 par value per share; authorized, 7,500 shares; issued and outstanding 3,935 and 3,821 shares, respectively	40	39
Additional paid-in capital	13,717	12,924
Retained earnings	17,407	16,623
Accumulated other comprehensive loss	(10,163)	(11,931)
Total shareholders' equity	21,001	17,655
Total liabilities and shareholders' equity	\$ 58,928	\$ 48,707

See accompanying notes to consolidated financial statements.





CSP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Amounts in thousands, except for per share data)

	For the years ended September 30, 2017		September 30, 2016	
Sales:				
Product	\$84,675		\$ 77,835	
Services	26,807		25,532	
Total sales	111,482		103,367	
Cost of sales:				
Product	71,302		63,539	
Services	14,690		14,787	
Total cost of sales	85,992		78,326	
Gross profit	25,490		25,041	
Operating expenses:				
Engineering and development	2,362		2,984	
Selling, general and administrative	19,356		18,256	
Total operating expenses	21,718		21,240	
Operating income	3,772		3,801	
Other expense:				
Foreign exchange loss	(3	)	(134	)
Other income (expense), net	24		(67	)
Total other income (expense), net	21		(201	)
Income before income taxes	3,793		3,600	
Income tax expense	1,287		996	
Net income	\$2,506		\$ 2,604	
Net income attributable to common stockholders	\$2,398		\$ 2,495	
Net income per share – basic	\$0.64		\$ 0.69	
Weighted average shares outstanding – basic	3,723		3,609	
Net income per share – diluted	\$0.63		\$ 0.67	
Weighted average shares outstanding – diluted	3,817		3,734	

See accompanying notes to consolidated financial statements.

CSP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Amounts in thousands)

	For the years ended	
	September 30,	September 30,
	2017	2016
Net income	\$2,506	\$ 2,604
Other comprehensive income (loss):		
Unrealized actuarial gain (loss) on minimum pension liability, net of tax effect	2,175	(3,564 )
Foreign currency translation gain (loss)	(407 )	18
Other comprehensive gain (loss)	1,768	(3,546 )
Total comprehensive income (loss)	\$4,274	\$ (942 )

See accompanying notes to consolidated financial statements.

## CSP INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

For the Year Ended September 30, 2017:

(Amounts in thousands)

	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated other comprehensive loss	Total Shareholders' Equity
Balance as of September 30, 2015	3,688	\$ 37	\$ 12,249	\$ 15,689	\$ (8,385 )	\$ 19,590
Comprehensive loss:						
Net income	—	—	—	2,604	—	2,604
Other comprehensive loss	—	—	—	—	(3,546 )	(3,546 )
Stock-based compensation	—	—	414	—	—	414
Restricted stock issuance	86	1	—	—	—	1
Issuance of shares under employee stock purchase plan	33	1	175	—	—	176
Exercise of stock options	14	—	86	—	—	86
Cash dividends on common stock (\$0.44 per share)	—	—	—	(1,670 )	—	(1,670 )
Balance as of September 30, 2016	3,821	39	12,924	16,623	(11,931 )	17,655
Comprehensive income:						
Net income	—	—	—	2,506	—	2,506
Other comprehensive income	—	—	—	—	1,768	1,768
Stock-based compensation	—	—	577	—	—	577
Restricted stock issuance	86	1	—	—	—	1
Issuance of shares under employee stock purchase plan	23	—	201	—	—	201
Exercise of stock options	5	—	15	—	—	15
Cash dividends on common stock (\$0.44 per share)	—	—	—	(1,722 )	—	(1,722 )
Balance as of September 30, 2017	3,935	\$ 40	\$ 13,717	\$ 17,407	\$ (10,163 )	\$ 21,001

See accompanying notes to consolidated financial statements.

CSP INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Amounts in thousands)

	For the years ended September 30, 2017		September 30, 2016	
Cash flows from operating activities:				
Net income	\$2,506		\$ 2,604	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation	553		570	
Amortization of intangibles	120		129	
Loss on disposal of property, equipment and improvements	5		51	
Foreign exchange loss	3		134	
Non-cash changes in accounts receivable	47		27	
Non-cash changes in inventory	294		602	
Stock-based compensation expense on stock options and restricted stock awards	577		414	
Deferred income taxes	262		(18	)
(Increase) decrease in cash surrender value of life insurance	(135	)	210	
Changes in operating assets and liabilities:				
Increase in accounts receivable	(8,095	)	(8	)
(Increase) decrease in officer life insurance settlement receivable	413		(413	)
Increase in inventories	(660	)	(814	)
(Increase) decrease in deferred costs	(797	)	23	
Decrease in refundable income taxes	34		44	
Decrease in other assets	3		322	
Increase (decrease) in accounts payable and accrued expenses	6,483		(1,648	)
Increase in deferred revenue	1,219		1,769	
Increase (decrease) in pension and retirement plans liability	(291	)	606	
Increase in income taxes payable	258		167	
Increase (decrease) in other long term liabilities	(140	)	233	
Net cash provided by operating activities	2,659		5,004	
Cash flows from investing activities:				
Life insurance premiums paid	(150	)	(161	)
Purchases of property, equipment and improvements	(358	)	(735	)
Net cash used in investing activities	(508	)	(896	)
Cash flows from financing activities:				
Dividends paid	(1,722	)	(1,670	)
Proceeds from issuance of shares under equity compensation plans	216		263	
Net cash used in financing activities	(1,506	)	(1,407	)
Effects of exchange rate on cash	137		(779	)
Net increase in cash and cash equivalents	782		1,922	
Cash and cash equivalents, beginning of period	13,103		11,181	
Cash and cash equivalents, end of period	\$13,885		\$ 13,103	
Supplementary cash flow information:				
Cash paid for income taxes	\$1,142		\$ 334	
Cash paid for interest	\$75		\$ 86	

See accompanying notes to consolidated financial statements.

37

---

CSP INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED SEPTEMBER 30, 2017 AND 2016

Organization and Business

CSP Inc. (“CSPI” or “the Company” or “we” or “our”) was founded in 1968 and is based in Lowell, Massachusetts. To meet the diverse requirements of commercial and defense customers worldwide, CSPI and its subsidiaries develop and market IT integration solutions and high-performance cluster computer systems. The Company operates in two segments, its HPP segment and its TS segment.

1. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant inter-company accounts and transactions have been eliminated. Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations.

Foreign Currency Translation

The U.S. Dollar is the reporting currency for all periods presented. The financial information for entities outside the United States is measured using the local currency as the functional currency. Assets and liabilities of the Company's foreign operations are translated into U.S. dollars at the exchange rates in effect at the balance sheet date. Revenue and expenses are translated at average rates in effect during the period. The resulting translation adjustment is reflected as accumulated other comprehensive income (loss), a separate component of shareholders' equity on the consolidated balance sheets. The translation adjustment for intercompany foreign currency loans that are of a long-term-investment nature is also reflected as accumulated other comprehensive income (loss). Currency transaction gains and losses are recorded as other income (expense) in the consolidated statements of operations.

Cash Equivalents

For purposes of the consolidated statements of cash flows, highly liquid investments with original maturities of three months or less at the time of acquisition are considered cash equivalents.

Fair Value of Financial Instruments

Our financial instruments are limited to cash and cash equivalents, accounts receivable, pension plan assets, accounts payable and our inventory line of credit. Fair value of these financial instruments was not materially different from their carrying values at September 30, 2017, and 2016.

Research and Development Expense

For the years ended September 30, 2017 and 2016, our expenses for research and development were approximately \$2.4 million and \$3.0 million, respectively. Expenditures for research and development are expensed as they are incurred.

## Impairment of Long-Lived Assets

The Company reviews its long-lived assets, including intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Management assesses the recoverability of the long-lived assets (other than goodwill) by comparing the estimated undiscounted cash flows associated with the related asset or group of assets against their respective carrying amounts. The amount of impairment, if any, is calculated based on the excess of the carrying amount over the fair value of those assets. Intangible assets that are not subject to amortization are also required to be tested annually, or more frequently if events or circumstances indicate that the asset may be impaired. We did not have intangible assets with indefinite lives at any time during the two years ended September 30, 2017. Intangible assets subject to amortization are amortized on a straight-line basis over their estimated useful lives, generally three to ten years, and are carried at net book value. The remaining useful lives of intangible assets are evaluated on an annual basis. Intangible assets subject to amortization are also tested for recoverability whenever events or changes in circumstances indicate

that their carrying amount may not be recoverable. If the fair value of an intangible asset subject to amortization is determined to be less than its carrying value, then an impairment charge is recorded to write down that asset to its fair value.

#### Inventories

Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out method. The recoverability of inventories is based upon the types and levels of inventories held, forecasted demand, pricing, competition and changes in technology. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required. For the years ended September 30, 2017, and September 30, 2016, the Company wrote down approximately \$294 thousand and \$602 thousand of inventory, respectively.

#### Property, Equipment and Improvements

The components of property, equipment and improvements are stated at cost. The Company provides for depreciation by use of the straight-line method over the estimated useful lives of the related assets (three to seven years). Leasehold improvements are amortized by use of the straight-line method over the lesser of the estimated useful life of the asset or the lease term. Repairs and maintenance costs are expensed as incurred. Property, equipment and improvements are tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. If the fair value of property, equipment and improvements is determined to be less than their carrying value, then an impairment charge is recorded to write down that asset to its fair value.

#### Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are stated at amounts that have been billed to customers less an allowance for doubtful accounts. Allowances for doubtful accounts are recorded for the estimated losses resulting from the inability of our customers to make required payments. The estimates for the allowance for doubtful accounts are based on the length of time the receivables are past due, current business environment and our historical experience. If the financial condition of our customers were to deteriorate, resulting in impairment of their ability to make payments, additional allowances may be required. Accounts receivable are charged off against the reserve when management has determined they are uncollectible.

#### Pension and Retirement Plans

The funded status of pension and other postretirement benefit plans is recognized on the consolidated balance sheet. Gains and losses, prior service costs and credits and any remaining transition amounts that have not yet been recognized through pension expense will be recognized in accumulated other comprehensive income, net of tax, until they are amortized as a component of net periodic pension/postretirement benefits expense. Additionally, plan assets and obligations are measured as of our fiscal year-end balance sheet date (September 30).

We have defined benefit and defined contribution plans in the United Kingdom (the “U.K.”), Germany and in the U.S. In the U.K. and Germany, the Company provides defined benefit pension plans for certain employees and former employees and defined contribution plans for the majority of the employees. The defined benefit plans in both the U.K. and Germany are closed to newly hired employees and have been for the two years ended September 30, 2017. In the U.S., the Company also provides defined contribution plans that cover most employees and supplementary



retirement plans to certain employees and former employees who are now retired. These supplementary retirement plans are also closed to newly hired employees and have been for the two years ended September 30, 2017. These supplementary plans are funded through whole life insurance policies. The Company expects to recover all insurance premiums paid under these policies in the future, through the cash surrender value of the policies and any death benefits or portions thereof to be paid upon the death of the participant. These whole life insurance policies are carried on the balance sheet at their cash surrender values as they are owned by the Company and not assets of the defined benefit plans. In the U.S., the Company also provides for officer death benefits and post-retirement health insurance benefits through supplemental post-retirement plans to certain officers. The Company also funds these supplemental plans' obligations through whole life insurance policies on the officers.

Pension expense is based on an actuarial computation of current future benefits using estimates for expected return on assets, expected compensation increases and applicable discount rates. Management has reviewed the discount rates and rates of return with our consulting actuaries and investment advisor and concluded they were reasonable. A decrease in the expected return on pension assets would increase pension expense. Expected compensation increases are estimated based on historical and expected increases in the future. Increases in estimated compensation increases would result in higher pension expense while decreases would lower pension expense. Discount rates are selected based upon rates of return on high quality fixed income investments currently available and expected to be available during the period to maturity of the pension benefit. A

decrease in the discount rate would result in greater pension expense while an increase in the discount rate would decrease pension expense.

The Company funds its pension plans in amounts sufficient to meet the requirements set forth in applicable employee benefits laws and local tax laws. Liabilities for amounts in excess of these funding levels are accrued and reported in the consolidated balance sheets.

### Segment Information

We have two operating segments; (i) High Performance Products ("HPP") and (ii) Technology Solutions ("TS"). In the HPP segment, we design, manufacture and deliver products and services to customers that require specialized cyber security services, networking and signal processing. In the TS segment, we focus on value added reseller ("VAR") integrated solutions including third party hardware, software and technical computer-related consulting and managed services. The operations and assets of our HPP segment are located in the United States. The operations and assets of our TS segment are located in the United States, Germany, and the United Kingdom.

### Revenue Recognition

We derive revenue from the sale of integrated hardware and software, professional services, maintenance contracts, other services, and third party service contracts. Professional services generally include implementation, installation, and training services. Other services generally include revenue generated through our royalty and extended warranty contracts. We recognize revenue when persuasive evidence of an arrangement exists, delivery of the product or service has occurred, the fee is fixed and determinable and collectability is reasonably assured. We enter into multiple element arrangements as well as standalone sales of product, professional services, and other services.

We recognize revenue from standalone product sales upon transfer of title, which is typically upon shipment, provided all other revenue recognition criteria have been met. Revenue generated from standalone professional services and extended warranty contracts is recognized as services are completed, provided all other revenue recognition criteria have been met. In some instances professional service contracts include a customer acceptance provision, in which case revenue is deferred until we have evidence of customer acceptance. We recognize revenue from usage based royalty contracts upon confirmation from the customer of shipment of the system produced pursuant to the royalty agreement.

We recognize revenue from multiple element arrangements in accordance with ASC 605-25, Multiple Element Arrangements. We evaluate multiple element arrangements to determine if separate units of accounting exist, and if so, we allocate revenue to each element based upon the relative selling price of each element. ASC 605-25 establishes a hierarchy for determining the amount to allocate to each separate deliverable in an arrangement. We determine selling price using vendor specific objective evidence ("VSOE"), if it exists; or, if VSOE does not exist, third party evidence ("TPE") of fair value if applicable; otherwise, we use the best estimate of selling price ("BESP"). The objective of BESP is to determine the price at which the Company would transact if the element was sold on a standalone basis. Management's determination of BESP involves several factors including budgeted profit margins, and cost to complete services.

We recognize revenue from third party service contracts as either gross sales or net sales in accordance with ASC 605-45, Principal Agent Considerations, which requires us to determine if the Company is acting as a principal party to the transaction or simply acting as an agent or broker. Under ASC 605-45, the assumption of the risks and rewards under the arrangement are considered indicators of principal parties to the arrangement. We record revenue as gross when it is a principal party to the arrangement and net of cost when we are acting as a broker or agent. Under gross sales recognition, the entire selling price is recorded in revenue and our cost to the third-party service provider or

vendor is recorded in cost of goods sold. Under net sales recognition, the cost to the third-party service provider or vendor is recorded as a reduction to revenue resulting in net sales equal to the gross profit on the transaction. The following policies are applicable to our major categories of segment revenue transactions:

#### HPP Segment Revenue

HPP segment revenue is derived from the sale of integrated hardware and software, maintenance, and other services through the Multicomputer and Myricom product lines. Multicomputer product revenue is generally recognized when product is shipped, provided that all revenue recognition criteria are met. Service revenue consists principally of other services which comprise of warranty and royalty revenue. Revenue generated from extended warranty contracts is recognized as services are completed, provided all other revenue recognition criteria have been met We recognize revenue from usage

based royalty contracts upon confirmation from the customer of shipment of the system produced pursuant to the royalty agreement. In the years ended September 30, 2017 and 2016, respectively, \$5.4 million and \$4.3 million of royalty income is included in service revenues.

Myricom revenue is derived from the sale of products, which are comprised of both hardware and embedded software which is essential to the products functionality, and post contract maintenance and support. Revenue on multiple element arrangements is recognized in accordance with ASC 605-25. We evaluate multiple element arrangements to determine if separate units of accounting exist, and if so, we allocate revenue to each element based upon the relative selling price of each element. We determine selling price using BESP. Management's determination of BESP is based on several factors, including, but not limited to, internal costs and gross margin objectives. Accordingly revenue for post contract maintenance and support is recognized over the implied maintenance period of either one or three years, and revenue for product sales is recognized upon delivery assuming all other revenue recognition criteria have been met.

#### TS Segment Revenue

TS Segment revenue is derived from the sale of hardware, software, professional services, and third party service contracts. TS product revenue is generally recognized when product is shipped, provided that all revenue recognition criteria are met. Service revenue consists of professional services which generally include implementation, installation, and training services. Revenue generated from standalone professional services is recognized as services are completed, provided all other revenue recognition criteria has been met. Our standard sales agreements generally do not include customer acceptance provisions. However, in certain instances when arrangements include a customer acceptance provision or there is uncertainty about customer acceptance, revenue is deferred until we have evidence of customer acceptance.

Revenue derived from the sale of products, which are comprised of both hardware and software, and professional services is recognized in accordance with ASC 605-25. We evaluate multiple element arrangements to determine if separate units of accounting exist, and if so, we allocate revenue to each element based upon the relative selling price of each element. We determine selling price using BESP. Management's determination of BESP is based on several factors, including, but not limited to, internal costs and gross margin objectives. Accordingly revenue for professional services is recognized as services are completed, and revenue for product sales is recognized upon delivery assuming all other revenue recognition criteria have been met.

We recognize revenue from certain third party service contracts, which are evaluated to determine whether such service revenue should be recorded as gross sales or net sales in accordance ASC 605-45. We evaluate all third party service contracts to determine whether we act as a principal in the transaction and assume the risks and rewards of ownership or if we are simply acting as an agent or broker. Under gross sales recognition, the entire selling price is recorded in sales and our cost to the third-party service provider or vendor is recorded in cost of goods sold. Under net sales recognition, the cost to the third-party service provider or vendor is recorded as a reduction to sales resulting in net sales equal to the gross profit on the transaction and there are no costs of goods sold. We use the net sales recognition method for the third party service contracts that we sell when we are not the primary obligor on the contract. We use the gross sales recognition for the third party service contracts that we sell when we act as principal and are the primary obligor.

#### Product Warranty Accrual

Our product sales generally include a hardware warranty which ranges from 90-days to three-years. At time of product shipment, we accrue for the estimated cost to repair or replace potentially defective products. Estimated warranty costs are based upon prior actual warranty costs for substantially similar products.

## Engineering and Development Expenses

Engineering and development expenses include payroll, employee benefits, stock-based compensation and other headcount-related expenses associated with product development. Engineering and development expenses also include third-party development and programming costs. We consider technological feasibility for our software products to be reached upon the release of the software, accordingly, no internal software development costs have been capitalized.

## Income Taxes

We use the asset and liability method of accounting for income taxes whereby deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using

enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We also reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods. This methodology requires estimates and judgments in the determination of the recoverability of deferred tax assets and in the calculation of certain tax liabilities. Valuation allowances are recorded against the gross deferred tax assets that management believes, after considering all available positive and negative objective evidence, historical and prospective, with greater weight given to historical evidence, that it is more likely than not that these assets will not be realized.

In addition, we are required to recognize in the consolidated financial statements, those tax positions determined to be more-likely-than-not of being sustained upon examination, based on the technical merits of the positions as of the reporting date. If a tax position is not considered more-likely-than-not to be sustained based solely on its technical merits, no benefits of the position are recognized.

In addition, the calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations in a multitude of jurisdictions. The Company records liabilities for estimated tax obligations in the U.S. and other tax jurisdictions. These estimated tax liabilities include the provision for taxes that may become payable in the future.

#### Earnings per Share of Common Stock

Basic net income per common share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted net income per common share reflects the maximum dilution that would have resulted from the assumed exercise and share repurchase related to dilutive stock options and is computed by dividing net income by the assumed weighted average number of common shares outstanding.

We are required to present earnings per share, or EPS, utilizing the two class method because we had outstanding, non-vested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, which are considered participating securities.

Basic and diluted earnings per share computations for the Company's reported net income attributable to common stockholders are as follows:

	For the years ended September 30, 2017    September 30, 2016 (Amounts in thousands except per share data)	
Net income	\$ 2,506	\$ 2,604
Less: Net income attributable to nonvested common stock	108	109
Net income attributable to common stockholders	\$ 2,398	\$ 2,495
Weighted average total shares outstanding - basic	3,890	3,766
Less: weighted average non-vested shares outstanding	167	157
Weighted average number of common shares outstanding - basic	3,723	3,609
Potential common shares from non-vested stock awards and the assumed exercise of stock options	94	125
Weighted average common shares outstanding - diluted	3,817	3,734
Net income per share - basic	\$ 0.64	\$ 0.69
Net income per share - diluted	\$ 0.63	\$ 0.67

All anti-dilutive securities, including stock options, are excluded from the diluted income per share computation. For the year ended September 30, 2017, there were no shares subject to stock options excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive. For the fiscal year ended September 30, 2016, approximately 25 thousand stock options were excluded from the diluted income per share calculation because their inclusion would have been anti-dilutive.

#### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues

and expenses during the reporting period. Actual results may differ from those estimates under different assumptions or conditions.

### Stock-Based Compensation

We measure and recognize compensation expense for all stock-based payment awards made to employees and directors including stock options and nonvested shares of restricted common stock based on estimated fair values of stock-based payment awards on the date of grant. The Company uses the Black-Scholes option-pricing model to calculate the fair value of stock option grants. The fair value of nonvested restricted share awards is equal to the quoted market price of our common stock as quoted on the Nasdaq Global Market on the date of grant. The fair value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's consolidated statements of operations.

Because stock-based compensation expense recognized in the consolidated statements of operations for the fiscal years ended September 30, 2017 and 2016 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures and will be revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Stock-based compensation expense recognized for the fiscal years ended September 30, 2017 and 2016 consisted of stock-based compensation expense related to options and restricted stock granted pursuant to the Company's stock incentive and employee stock purchase plans of approximately \$0.6 million and \$0.4 million, respectively.

### Concentrations of Credit Risk

Cash and cash equivalents are maintained with several financial institutions in the U.S., Germany and in the U.K. Deposits held with banks may exceed the amount of insurance on such deposits. Generally, these deposits may be redeemed upon demand. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

### Subsequent Events

The Company recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of financial position, including the estimates inherent in the process of preparing financial statements. The Company has evaluated subsequent events through the date of this filing.

### New Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for the Company on October 1, 2018, and it does not plan to early adopt this ASU. The standard outlines a five-step model whereby revenue is recognized as performance obligations within a contract are satisfied. The standard also requires new, expanded disclosures regarding revenue recognition. We are utilizing a bottom-up approach to analyze the standard's impact on our contract portfolio, comparing our historical accounting policies and practices, and identifying potential differences from applying the requirements of the new standard to our contracts. While this assessment continues, we have not yet completed our determination of the impacts of the standard or the effect of these impacts on our consolidated financial statements. Consequently, we have not yet selected a transition method. We expect this determination will near completion in the first half of 2018. Because the new standard will impact our business processes, systems and controls, we are developing a comprehensive change



management project plan to guide the implementation.

Effective September 30, 2017, the Company adopted FASB ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, an amendment of the FASB Accounting Standards Codification. The ASU has added additional disclosure requirements to the codification. It requires management to assess, at each interim and annual reporting period, whether substantial doubt exists about an entity's ability to continue as a going concern. Substantial doubt exists if it is probable (the "probable" threshold under GAAP has generally been interpreted to be between 75 and 80 percent) that the entity will be unable to meet its obligations as they become due within one year after the date the financial statements are issued or available to be issued (assessment date). This guidance did not have an impact to the Company's consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330) Simplifying the Measurement of Inventory, which requires entities to measure inventory at the lower of cost and net realizable value, except for inventory measured using last-in, first-out (LIFO) or the retail inventory method. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017 and requires prospective application, with early adoption permitted as of the beginning of an interim or annual reporting period. The Company has not yet assessed the potential impact of implementing this ASU on our consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, Income Taxes (Topic 740) Balance Sheet Classification of Deferred Taxes, which require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in this Topic apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this Topic. The amendments in this Topic are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Beginning October 1, 2017, the Company adopted the ASU and it hasn't had a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), an amendment of the FASB Accounting Standards Codification. This ASU requires lessees to recognize a right-of-use asset and lease liability for most lease arrangements. The new standard is effective for the Company on October 1, 2019. The standard mandates a modified retrospective transition method for all entities and early adoption is permitted. The Company is evaluating the effect that ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-08 (Topic 606), Principal versus Agent Considerations (Reporting Revenue Gross versus Net) to clarify the implementation guidance on principal versus agent considerations. The amendments in this update provides additional guidance on indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to the customer and does not change the core principle of previously issued guidance. The amendments in this Topic are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The Company does not expect the implementation of this ASU to have a material impact on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09 (Topic 718), Compensation - Stock Compensation, Improvements to Employee Share-Based Payment Accounting to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Additionally, the amendments eliminate the guidance in Topic 718 that was indefinitely deferred shortly after the issuance of FASB Statement No. 123 (revised 2004), Share-Based Payment. This should not result in a change in practice because the guidance that is being superseded was never effective. The Company has adopted this ASU effective October 1, 2017 and it hasn't had a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, an amendment of the FASB Accounting Standards Codification. This ASU will reduce diversity in practice for classifying cash payments and receipts in the statement of cash flows for a number of common transactions. It will also clarify when identifiable cash flows should be separated versus classified based on their predominant source or use. This ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the

same period. The Company is evaluating the effect that ASU 2016-15 will have on its consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, an amendment of the FASB Accounting Standards Codification. This ASU requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except transfers of inventory). Under current GAAP, the seller and buyer defer the consolidated tax consequences of an intercompany asset transfer from the period of the transfer to a future period when the asset is transferred out of the consolidated group, or otherwise affects consolidated earnings. This standard will cause volatility in companies' effective tax rates, particularly for those that transfer intangible assets to foreign subsidiaries. For public entities, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2017. An entity may early adopt the standard but only at the beginning of an annual period for which it has not issued or made available for issuance financial statements (interim or

annual). The Company is evaluating the effect that ASU 2016-16 will have on its consolidated financial statements and related disclosures.

In January 2017, FASB issued ASU No. 2017-01, "Business Combinations Clarifying the Definition of a Business" (Topic 805) ("ASU No. 2017-01"). ASU 2017-01 provides a framework to use in determining when a set of assets and activities is a business. ASU 2017-01 provides more consistency in applying the business combination guidance, reduces the costs of application, and makes the definition of a business more operable. ASU 2017-01 is effective for interim and annual periods within those annual periods beginning after December 15, 2017. The Company is currently evaluating the impact ASU 2017-01 will have on the Company's results of operations, financial position and disclosures.

In March 2017, the FASB issued ASU No. 2017-07, Compensation Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, an amendment of the FASB Accounting Standards Codification. This ASU requires employers that sponsor defined benefit pension and/or other post-retirement benefit plans to report the service cost component of net benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. Employers are required to present the other components of net benefit costs in the income statement separately from the service cost component and outside a subtotal of income from operations. Additionally, only the service cost component of net periodic pension cost will be eligible for asset capitalization. For public entities, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within that annual period. Early adoption is permitted as of the beginning of an annual period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit in assets. The Company is evaluating the effect that ASU 2017-07 will have on its consolidated financial statements and related disclosures.

## 2. Inventories

Inventories consist of the following:

	September 30,	
	2017	2016
	(Amounts in thousands)	
Raw materials	\$1,334	\$ 1,658
Work-in-process	260	814
Finished goods	4,377	3,108
Total	\$5,971	\$ 5,580

Finished goods includes inventory that has been shipped, but for which all revenue recognition criteria has not been met, of approximately \$0.4 million and \$0.1 million as of September 30, 2017 and September 30, 2016, respectively.

## 3. Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss are as follows:

	Effect of Foreign Currency Translation	Minimum Pension Liability	Accumulated Other Comprehensive Loss
(Amounts in thousands)			
Balance as of September 30, 2015	\$(2,825)	\$(5,560 )	\$ (8,385 )
Change in period	18	(3,413 )	(3,395 )
Tax effect of change in period	—	(151 )	(151 )
Balance as of September 30, 2016	\$(2,807)	\$(9,124 )	\$ (11,931 )
Change in period	(407 )	1,944	1,537
Tax effect of change in period	—	231	231
Balance as of September 30, 2017	\$(3,214)	\$(6,949 )	\$ (10,163 )

The changes in the minimum pension liability are net of amortization of net gain of \$389 thousand in 2017 and net gain of \$90 thousand in 2016 included in net periodic pension cost.

## 4. Income Taxes

The components of income before income tax and income tax expense are comprised of the following:

	For the Years Ended September 30,	
	2017	2016
(Amounts in thousands)		
Income before income tax:		
U.S.	\$ 3,383	\$ 3,418
Foreign	410	182
	\$ 3,793	\$ 3,600
Income tax expense:		
Current:		
Federal	\$ 1,067	\$ 303
State	119	118
Foreign	132	159
	1,318	580
Deferred:		
Federal	(86 )	400
State	37	46
Foreign	18	(30 )
	(31 )	416
	\$ 1,287	\$ 996

As of September 30, 2017, management assessed the positive and negative evidence in the U.S operations, and estimated we will have sufficient future taxable income to utilize the existing deferred tax assets, except for certain state tax

credit carry-forwards. Significant objective positive evidence included the cumulative profits that we realized over the most recent years. This evidence enhances our ability to consider other subjective evidence such as our projections for future growth. Other factors we considered are the likelihood for continued royalty income in future years, and our expectation that the TS segment will continue to be profitable in future years. On the basis of this evaluation, as of September 30, 2017, we have concluded that our U.S. deferred tax asset is more likely than not to be realized. It should be noted however, that the amount of the deferred tax asset realized could be adjusted in future years, if estimates of taxable income during the carryforward periods are reduced, or if objective negative evidence in the form of cumulative losses is present.

The recording and ultimate reversal of valuation allowances for our deferred tax asset requires significant judgment associated with past and projected performance. In assessing the realizability of deferred tax assets, we consider our taxable future earnings and the expected timing of the reversal of temporary differences. We recorded a valuation allowance which reduced the gross deferred tax asset to an amount that we believed was more likely than not to be realized because of the cumulative losses incurred in the U.K. in recent years represented sufficient negative evidence to record a valuation allowance against certain deferred tax assets.

We continue to maintain a full valuation allowance against our U.K. deferred tax assets as we have experienced cumulative losses and do not have any indication that the operation will be profitable in the future to an extent that will allow us to utilize much of our net operating loss carryforwards. To the extent that actual experience deviates from our assumptions, our projections would be affected and hence our assessment of realizability of our deferred tax assets may change.

Reconciliation of federal statutory rate and income tax expense to the Company's effective tax rate and actual income tax expense is as follows:

	For the Years Ended September 30,					
	2017			2016		
	(Dollar amounts in thousands)					
Computed “expected” tax expense	\$1,289	34.0	%	\$1,224	34.0	%
Increases (reductions) in taxes resulting from:						
State income taxes, net of federal tax benefit	80	2.1	%	124	3.5	%
Foreign operations	11	0.3	%	67	1.9	%
Permanent differences	(4	)	(0.1 )%	(20	)	(0.6 )%
Change in valuation allowance	(37	)	(1.0 )%	—	—	%
Uncertain tax liability adjustment	8	0.2	%	8	0.2	%
Research & development credit	(53	)	(1.4 )%	(344	)	(9.6 )%
Other items	(7	)	(0.2 )%	(63	)	(1.7 )%
Income tax expense	\$1,287	33.9	%	\$996	27.7	%

For the years ended September 30, 2017 and 2016, temporary differences, which give rise to deferred tax assets (liabilities), are as follows:

	September 30, 2017	September 30, 2016
	(Amounts in thousands)	
Deferred tax assets:		
Pension	\$2,470	\$ 2,896
Intangibles	219	315
Other reserves and accruals	633	671
Inventory reserves and other	563	470
State credits, net of federal benefit	318	313
Federal and state net operating loss carryforwards	52	61
Foreign net operating loss carryforwards	1,531	1,704
Foreign exchange on intercompany loan	(77 )	—
Foreign tax credits	7	7
Depreciation and amortization	(177 )	(203 )
Gross deferred tax assets	5,539	6,234
Less: valuation allowance	(2,712 )	(3,180 )
Realizable deferred tax asset	2,827	3,054
Gross deferred tax liabilities	—	—
Net deferred tax assets	\$2,827	\$ 3,054

The deferred tax valuation allowance decreased by approximately \$468 thousand, as shown above. In assessing the realizability of deferred tax assets, the Company considers its taxable future earnings and the expected timing of the reversal of temporary differences. Accordingly, the Company has recorded a valuation allowance which reduces the gross deferred tax asset to an amount which management believes will more likely than not be realized. The valuation allowance was determined by assessing both positive and negative evidence whether it is more likely than not that deferred tax assets are realizable. Such assessment is done on a jurisdiction-by-jurisdiction basis. The Company's inability to project future profitability beyond fiscal year 2017 and the cumulative losses incurred in recent years in the U.K. represent sufficient negative evidence to record a valuation allowance against certain deferred tax assets.

As of September 30, 2017 and 2016, the Company had U.S. net operating loss carryforwards for state tax purposes of approximately \$0.4 million and \$0.4 million, respectively, which are available to offset future taxable income through 2033.

As of September 30, 2017, the Company had other state tax credit carryforwards of \$55 thousand available to reduce future state tax expense which has unlimited carryover status.

As of September 30, 2017, the Company concluded that a net increase of \$43 thousand of the valuation allowance for the U.S. was appropriate. As part of the Company's analysis, the Company evaluated, among other factors, its recent history of generating taxable income in state jurisdictions and its near-term forecasts of future taxable income. The net increase in the Company's valuation allowance of \$43 thousand is to reserve for state tax credit carryforwards that the Company believes will expire unused.

As of September 30, 2017, the Company had U.K. net operating loss carryforwards of approximately \$9.0 million that have an indefinite life with no expiration.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$2.8 million and \$2.5 million at September 30, 2017 and 2016, respectively. The Company's policy is that its undistributed foreign earnings are indefinitely reinvested and, accordingly, no U.S. federal and state deferred tax liabilities have been recorded.

In addition, the calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax regulations in a multitude of jurisdictions. The Company records liabilities for estimated tax obligations in the U.S. and other tax jurisdictions. These estimated tax liabilities include the provision for taxes that may become payable in the future.

As of September 30, 2017, the total amount of uncertain tax liabilities was \$209 thousand. We recognized \$7 thousand of interest and potential penalties accrued related to unrecognized tax benefits in our provision for income taxes.



A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows:

	For the Year Ended September 30, 2017 (Amounts in thousands)	For the Year Ended September 30, 2016
Balance, beginning of year	\$ 202	\$ 195
Accrued penalties and interest	7	7
Balance, end of period	\$ 209	\$ 202

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The Company has reviewed the tax positions taken on returns filed domestically and in its foreign jurisdictions for all open years, generally fiscal 2014 through 2017, and believes that tax adjustments in any audited year will not be material, except for the uncertain tax position described above.

On December 20, 2017, the Tax Cuts and Jobs Act bill was passed by Congress. Once the bill is signed into law, the change in the tax law will lower our overall tax rate and reduce our deferred taxes and will be treated as a discrete item in the quarter enacted. We will still need to assess the effect of the new law when enacted on our effective tax rate.

#### 5. Property, Equipment and Improvements, Net

Property, equipment and improvements, net consist of the following:

	September 30, 2017	September 30, 2016
	(Amounts in thousands)	
Leasehold improvements	\$224	\$ 263
Equipment	9,055	8,629
Automobiles	74	74
	9,353	8,966
Less accumulated depreciation and amortization	(7,845 )	(7,286 )
Property, equipment and improvements, net	\$ 1,508	\$ 1,680

The Company uses the straight-line method over the estimated useful lives of the assets to record depreciation expense. Depreciation expense was \$553 thousand and \$570 thousand for the years ended September 30, 2017 and 2016, respectively.

#### 6. Acquired Intangible Assets

As of September 30, 2017 and 2016, intangible assets are as follows:

	September 30, 2017				September 30, 2016			
	Weighted Average		Accumulated	Net	Weighted Average		Accumulated	Net
	Remaining	Gross	Amortization		Remaining	Gross	Amortization	
	Amortization Period				Amortization Period			
	(Amounts in thousands)							
Customer list	2 years	\$910	\$ 773	\$137	3 years	\$910	\$ 682	\$228
Non-compete agreements	0 years	93	93	—	0 years	93	93	—
Developed technology	0 years	30	\$ 30	\$—	0 years	30	29	1
Trade name	1 year	140	\$ 110	\$30	2 years	140	82	58
Total		\$1,173	\$ 1,006	\$167		\$1,173	\$ 886	\$287

Amortization expense on these intangible assets was \$120 thousand and \$129 thousand for fiscal 2017 and 2016, respectively.

Annual amortization expense related to intangible assets for each of the following successive fiscal years is as follows:

Fiscal year ending September 30: (Amounts in thousands)

2018	119
2019	11
2020	9
2021	9
2022	9
Thereafter	10
Total	\$ 167

## 7. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following:

	September 30,	
	2017	2016
	(Amounts in thousands)	
Accounts payable	\$ 10,941	\$ 4,360
Inventory line of credit	3,110	3,151
Commissions	269	269
Compensation and fringe benefits	2,147	2,139
Professional fees and shareholders' reporting costs	789	594
Taxes, other than income	866	353
Warranty	121	131
Other	602	935
	\$ 18,845	\$ 11,932

## 8. Product Warranties

Product warranty activity for the years ended September 30 was as follows:

	2017	2016
Balance at the beginning of the period	\$ 130,841	\$ 125,423
Accruals for warranties for products sold in the period	75,816	52,066
Fulfillment of warranty obligations	(85,207 )	(46,648 )
Balance at the end of the period	\$ 121,450	\$ 130,841

## 9. Stock Based Incentive Compensation

In 1997, the Company adopted the 1997 Stock Option Plan (the “1997 Plan”), and authorized 199,650 shares of common stock to be reserved for issuance pursuant to the 1997 Plan. The 1997 plan expired in 2007. Because the 1997 Plan has expired, no further awards will be issued under this plan. In 2003, the Company adopted the 2003 Stock Incentive Plan (the “2003 Plan”) and authorized 200,000 shares of common stock to be reserved for issuance pursuant to the 2003 Plan. The 2003 plan expired in 2013. Because the 2003 Plan has expired, no further awards will be issued under this plan. In 2007, the Company adopted the 2007 Stock Incentive Plan (the “2007 Plan”) and authorized 250,000 shares of common stock to be reserved for issuance pursuant to the 2007 Plan. The 2007 plan expired in 2017. Because the 2007 Plan has expired, no further awards will be issued under this plan. In 2015, the Company adopted the 2015 Stock Incentive Plan (the “2015 Plan”) and authorized

300,000 shares of common stock to be reserved for issuance pursuant to the 2015 Plan. As of September 30, 2017, there were 183,965 shares available to be granted under the 2015 Plan. Under all of the stock incentive plans, both incentive stock options and non-qualified stock options may be granted to officers, key employees and other persons providing services to the Company. The 2003 Plan and 2007 Plan also provide for awards of nonvested shares of common stock. All of the Company's stock incentive plans have a ten year life. The total number of available shares under all plans for future awards was 183,965 as of September 30, 2017.

Awards issued under any of the stock option plans are not affected by termination of the plan. The Company issues stock options at their fair market value on the date of grant. Vesting of stock options granted pursuant to the Company's stock incentive plans is determined by the Company's compensation committee. Generally, options granted to employees vest over four years and expire ten years from the date of grant. Options granted to non-employee directors have historically included cliff vesting after six months from the date of grant and expire three years from the date of grant. In fiscal years 2015 through 2017, the Company granted certain officers including its Chief Executive Officer and non-employee directors, and key employees shares of nonvested common stock instead of stock options. The vesting periods for the officers', the Chief Executive Officer's and the directors' nonvested stock awards are four years, three years and one year, respectively. The vesting period for the key employees' awards is four years.

We measure and recognize compensation expense for all stock-based payment awards made to employees and directors including employee stock options and awards of nonvested stock based on estimated fair values, as described in Note 1. Stock-based compensation expense incurred and recognized for the years ended September 30, 2017 and 2016 related to stock options and nonvested stock granted to employees and non-employee directors under the Company's stock incentive and employee stock purchase plans totaled approximately \$577 thousand and \$414 thousand, respectively. The classification of the cost of stock-based compensation, in the consolidated statements of operations, is consistent with the nature of the services being rendered in exchange for the share based payment. The following table summarizes stock-based compensation expense in the Company's consolidated statements of operations:

	Years ended	
	September 30, 2017	September 30, 2016
	(Amounts in thousands)	
Cost of sales	\$6	\$ 2
Engineering and development	24	6
Selling, general and administrative	547	406
Total	\$577	\$ 414

For the year ended September 30, 2017, the Company granted 34,000 nonvested shares to certain key employees, 40,000 nonvested shares to certain officers including 30,000 shares granted to the Chief Executive Officer, and 20,000 nonvested shares to its non-employee directors. For the year ended September 30, 2016, the Company granted 28,000 nonvested shares to certain key employees, 57,000 nonvested shares to certain officers including 40,000 to its Chief Executive Officer and 20,395 nonvested shares to its non-employee directors.

The Company measures the fair value of nonvested stock awards based upon the market price of its common stock as of the date of grant. The Company used the Black-Scholes option-pricing model to value stock options. The Black-Scholes model requires the use of a number of assumptions including volatility of the Company's stock price, the weighted average risk-free interest rate and the weighted average expected life of the options, at the time of grant.

The expected dividend yield is equal to the dividend per share declared, divided by the closing share price on the date the options were granted. All equity compensation awards granted for the years ended September 30, 2017 and September 30, 2016 were nonvested stock awards.

As stock-based compensation expense recognized in the consolidated statements of operations is based on awards ultimately expected to vest, expense for grants beginning upon adoption on October 1, 2005 has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The forfeiture rates for the years ended September 30, 2017 and 2016 were based on actual forfeitures.

No cash was used to settle equity instruments granted under share-based payment arrangements in any of the years in the two-year period ended September 30, 2017.

The following tables provide summary data of stock option award activity:

	Number of Shares	Weighted average exercise price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding at September 30, 2015	55,126	\$ 6.43	—	—
Granted	—	—	—	—
Expired	(17,500)	\$ 6.61	—	—
Forfeited	—	—	—	—
Exercised	(14,000)	6.20	—	—
Outstanding at September 30, 2016	23,626	\$ 5.76	—	—
Granted	—	—	—	—
Expired	(9,250 )	\$ 9.30	—	—
Forfeited	—	—	—	—
Exercised	(5,000 )	2.99	—	—
Outstanding at September 30, 2017	9,376	\$ 4.49	1.35 Years	\$ 62
Exercisable at September 30, 2017	9,376	\$ 4.49	1.35 Years	\$ 62
Vested and expected to vest at September 30, 2017	9,376	\$ 4.49	1.35 Years	\$ 62

There were no stock options granted in the years ended September 30, 2017 and 2016. The aggregate intrinsic value of stock options exercised during the years ended September 30, 2017 and 2016 was \$38 thousand and \$51 thousand, respectively.

The following table provides summary data of nonvested stock award activity:

	Number of nonvested shares	Weighted Average grant date Fair Value	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Nonvested shares outstanding at September 30, 2015	130,457	\$ 6.08	2.12 Years	\$ 714
Activity in 2016:				
Granted	105,395	\$ 6.47	—	—
Vested	(48,444 )	\$ 6.33	—	—
Forfeited	(21,700 )	7.38	—	—
Nonvested shares outstanding at September 30, 2016	165,708	\$ 6.38	2.20 Years	\$ 1,695
Activity in 2017:				
Granted	94,000	\$ 10.18	—	—
Vested	(71,587 )	\$ 6.59	—	—
Forfeited	(8,300 )	7.11	—	—
Nonvested shares outstanding at September 30, 2017	179,821	\$ 8.64	2.23 Years	\$ 1,987
Vested at September 30, 2017	250,864	\$ 5.96	0.31 Years	\$ 2,772
Vested and expected to vest at September 30, 2017	430,685	\$ 7.08	1.11 Years	\$ 4,759

As of September 30, 2017, there was \$1.09 million of total unrecognized compensation cost related to nonvested stock-based compensation arrangements (including stock option and nonvested stock awards) granted under the Company's stock incentive plans. This cost is expected to be expensed over a weighted average period of approximately 2.68 years. The total fair value of shares vested during the years ended September 30, 2017 and 2016 was \$472 thousand and \$307 thousand, respectively.



## 10. Employee Stock Purchase Plan

In December 2013, the Board of Directors of the Company adopted the 2014 Employee Stock Purchase Plan covering up to 250,000 shares of Common Stock (the "ESPP"), which was ratified by a vote of the Company's shareholders in February 2014. Under the ESPP, the Company's employees may purchase shares of common stock at a price per share that is currently 95% of the lesser of the fair market value as of the beginning or end of semi-annual option periods. Pursuant to the ESPP, the Company issued 22,996 and 33,248 shares for the two years ended September 30, 2017 and September 30, 2016, respectively. Since inception of the plan, there are 149,086 shares available for future issuance under the ESPP as of September 30, 2017.

## 11. Pension and Retirement Plans

We have defined benefit and defined contribution plans in the U.K., Germany and in the U.S. In the U.K. and Germany, the Company provides defined benefit pension plans for certain employees and former employees and defined contribution plans for the majority of the employees. The defined benefit plans in both the U.K. and Germany are closed to newly hired employees and have been for the two years ended September 30, 2017. In the U.S., the Company also provides defined contribution plans that cover most employees and supplementary retirement plans to certain employees and former employees who are now retired. These supplementary retirement plans are also closed to newly hired employees and have been for the two years ended September 30, 2017. These supplementary plans are funded through whole life insurance policies. The Company expects to recover all insurance premiums paid under these policies in the future, through the cash surrender value of the policies and any death benefits or portions thereof to be paid upon the death of the participant. These whole life insurance policies are carried on the balance sheet at their cash surrender values as they are owned by the Company and not assets of the defined benefit plans. In the U.S., the Company also provides for officer death benefits and post-retirement health insurance benefits through supplemental post-retirement plans to certain officers. The Company also funds these supplemental plans' obligations through whole life insurance policies on the officers.

### Defined Benefit Plans

The Company funds its pension plans in amounts sufficient to meet the requirements set forth in applicable employee benefits laws and local tax laws. Liabilities for amounts in excess of these funding levels are accrued and reported in the consolidated balance sheet.

The German Plan does not have any assets and therefore all costs and benefits of the plan are funded annually with cash flow from operations.

The domestic supplemental retirement plans have life insurance policies which are not considered plan assets but were purchased by the Company as a vehicle to fund the costs of the plan. These insurance policies are included in the balance sheet at their cash surrender value, net of policy loans, aggregating \$2.1 million and \$1.9 million as of September 30, 2017 and 2016, respectively. The loans against the policies have been taken out by the Company to pay the premiums. The costs and benefit payments for these plans are paid through operating cash flows of the Company to the extent that they cannot be funded through the use of the cash values in the insurance policies. The Company expects that the recorded value of the insurance policies will be sufficient to fund all of the Company's obligations under these plans.

Assumptions:

The following table provides the weighted average actuarial assumptions used to determine the actuarial present value of projected benefit obligations at:

	Domestic		International	
	September 30,		September 30,	
	2017	2016	2017	2016
Discount rate:	3.75 %	3.50 %	2.34 %	1.77 %
Expected return on plan assets:			3.70 %	3.60 %
Rate of compensation increase:			1.00 %	1.00 %

The following table provides the weighted average actuarial assumptions used to determine net periodic benefit cost for years ended:

	Domestic September 30,		International September 30,	
	2017	2016	2017	2016
Discount rate:	3.50 %	4.25 %	1.77 %	3.10 %
Expected return on plan assets:			3.60 %	4.20 %
Rate of compensation increase:			1.00 %	1.00 %

For domestic plans, the discount rate was determined by comparison against the Citigroup Pension Discount Curve and Liability Index for AA rated corporate instruments. The Company monitors other indices to assure that the pension obligations are fairly reported on a consistent basis. The international discount rates were determined by comparison against country specific AA corporate indices, adjusted for duration of the obligation.

The periodic benefit cost and the actuarial present value of projected benefit obligations are based on actuarial assumptions that are reviewed on an annual basis. The Company revises these assumptions based on an annual evaluation of long-term trends, as well as market conditions that may have an impact on the cost of providing retirement benefits.

The components of net periodic benefit costs related to the U.S. and international plans are as follows:

	Years Ended September 30					
	2017			2016		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(amounts in thousands)					
Pension:						
Service cost	\$41	\$—	\$41	\$35	\$—	\$35
Interest cost	386	29	415	571	43	614
Expected return on plan assets	(268 )	—	(268 )	(357 )	—	(357 )
Amortization of net (gain)/loss	370	4	374	174	(5 )	169
Net periodic benefit cost	\$529	\$33	\$562	\$423	\$38	\$461
Post Retirement:						
Service cost	\$—	\$38	\$38	\$—	\$27	\$27
Interest cost	—	44	44	—	42	42
Amortization of net (gain)/loss	—	15	15	—	(79 )	(79 )
Net periodic benefit cost	\$—	\$97	\$97	\$—	\$(10 )	\$(10 )
Pension:						
Increase (decrease) in minimum liability included in other comprehensive income (loss)	\$(1,831)	\$(14 )	\$(1,845)	\$3,105	\$25	\$3,130
Post Retirement:						
Increase (decrease) in minimum liability included in other comprehensive income (loss)	—	(99 )	(99 )	—	283	283
Total:						
Increase (decrease) in minimum liability included in comprehensive income (loss)	\$(1,831)	\$(113)	\$(1,944)	\$3,105	\$308	\$3,413



The following table presents an analysis of the changes in 2017 and 2016 of the benefit obligation, the plan assets and the funded status of the plans:

	Years Ended September 30					
	2017			2016		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(Amounts in thousands)					
Pension:						
Change in projected benefit obligation (“PBO”)						
Balance beginning of year	\$19,564	\$829	\$20,393	\$17,979	\$1,022	\$19,001
Service cost	42	—	42	35	—	35
Interest cost	386	29	415	571	43	614
Changes in actuarial assumptions	(1,582 )	(9 )	(1,591 )	3,948	20	3,968
Foreign exchange impact	651	—	651	(2,069 )	—	(2,069 )
Benefits paid	(402 )	(172 )	(574 )	(900 )	(256 )	(1,156 )
Projected benefit obligation at end of year	\$18,659	\$677	\$19,336	\$19,564	\$829	\$20,393
Changes in fair value of plan assets:						
Fair value of plan assets at beginning of year	\$7,629	\$—	\$7,629	\$9,301	\$—	\$9,301
Actual gain on plan assets	368	—	368	111	—	111
Company contributions	376	172	548	406	256	662
Foreign exchange impact	268	—	268	(1,289 )	—	(1,289 )
Benefits paid	(402 )	(172 )	(574 )	(900 )	(256 )	(1,156 )
Fair value of plan assets at end of year	\$8,239	\$—	\$8,239	\$7,629	—	\$7,629
Funded status \ net amount recognized	\$(10,420)	\$(677 )	\$(11,097)	\$(11,935)	\$(829 )	\$(12,764)
Post Retirement:						
Change in projected benefit obligation (“PBO”):						
Balance beginning of year	\$—	\$1,257	\$1,257	\$—	\$985	\$985
Service cost	—	38	38	—	27	27
Interest cost	—	44	44	—	42	42
Changes in actuarial assumptions	—	(84 )	(84 )	—	203	203
Projected benefit obligation at end of year	\$—	\$1,255	\$1,255	\$—	\$1,257	\$1,257
Funded status \ net amount recognized	\$—	\$(1,255)	\$(1,255 )	\$—	\$(1,257)	\$(1,257 )

The amounts recognized in the consolidated balance sheet consist of:

	Years Ended September 30					
	2017			2016		
	Foreign	U.S.	Total	Foreign	U.S.	Total
	(Amounts in thousands)					
Pension:						
Accrued benefit liability	\$(10,420)	\$(677 )	\$(11,097)	\$(11,936)	\$(829 )	\$(12,765)
Deferred tax	(493 )	19	(474 )	(216 )	14	(202 )
Accumulated other comprehensive income	6,893	18	6,911	9,001	26	9,027
Net amount recognized	\$(4,020 )	\$(640 )	\$(4,660 )	\$(3,151 )	\$(789 )	\$(3,940 )
Post Retirement:						
Accrued benefit liability	\$—	\$(1,255)	\$(1,255 )	\$—	\$(1,257)	\$(1,257 )
Deferred tax	—	91	91	—	52	52
Accumulated other comprehensive income (loss)	—	38	38	—	97	97
Net amount recognized	\$—	\$(1,126)	\$(1,126 )	\$—	\$(1,108)	\$(1,108 )
Total pension and post retirement:						
Accrued benefit liability	\$(10,420)	\$(1,932)	\$(12,352)	\$(11,936)	\$(2,086)	\$(14,022)
Deferred tax	(493 )	110	(383 )	(216 )	66	(150 )
Accumulated other comprehensive income	6,893	56	6,949	9,001	123	9,124
Net amount recognized	\$(4,020 )	\$(1,766)	\$(5,786 )	\$(3,151 )	\$(1,897)	\$(5,048 )
Accumulated Benefit Obligation:						
Pension	\$(18,514)	\$(677 )	\$(19,191)	\$(19,396)	\$(829 )	\$(20,225)
Post Retirement	—	(1,255 )	(1,255 )	—	(1,257 )	(1,257 )
Total accumulated benefit obligation	\$(18,514)	\$(1,932)	\$(20,446)	\$(19,396)	\$(2,086)	\$(21,482)

Plans with projected benefit obligations in excess of plan assets are attributable to unfunded domestic supplemental retirement plans, our German plans which are legally not required to be funded and our U.K. retirement plan.

Accrued benefit liability reported as:

	September 30,	
	2017	2016
	(Amounts in thousands)	
Current accrued benefit liability	\$ 534	\$ 581
Non-current accrued benefit liability	11,818	13,441
Total accrued benefit liability	\$ 12,352	\$ 14,022

As of September 30, 2017 and 2016, the amounts included in accumulated other comprehensive income, consisted of deferred net losses totaling approximately \$6.9 million and \$9.1 million, respectively.

The amount of net deferred gain expected to be recognized as a component of net periodic benefit cost for the year ending September 30, 2018, is approximately \$186 thousand.

#### Contributions

The Company expects to contribute \$0.5 million to its pension plans for fiscal 2018.

### Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (amounts in thousands):

Fiscal year ending September 30:	(Amounts in thousands)
2018	\$ 606
2019	651
2020	667
2021	691
2022	724
Thereafter	4,225

### Plan Assets

At September 30, 2017, our pension plan in the U.K. was the only plan with assets, holding investments of approximately \$8.2 million. Pension plan assets are managed by a fiduciary committee. The Company's investment strategy for pension plan assets is to maximize the long-term rate of return on plan assets within an acceptable level of risk while maintaining adequate funding levels. Local regulations, local funding rules, and local financial and tax considerations are part of the funding and investment process. In deciding on the investments to be held, the trustees take into account the risk of possible fluctuations in income from, and market values of, the assets as well as the risk of departing from an asset profile which broadly matches the liability profile. The committee has invested the plan assets in a single pooled fund with an authorized investment company (the "Fund"). The Fund selected by the trustees is consistent with the plan's overall investment principles and strategy described herein. There are no specific targets as to asset allocation other than those contained within the Fund that is managed by the authorized investment company.

The fair value of the assets held by the U.K. pension plan by asset category are as follows:

Asset Category	Fair Values as of September 30, 2017				September 30, 2016			
	Fair Value Measurements Using Inputs Considered as				Fair Value Measurements Using Inputs Considered as			
	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
	(Thousands)							
Cash on deposit	\$62	\$62	\$	—\$	—\$86	\$86	\$	—\$ —
Pooled funds	8,177	8,177	—	—	7,543	7,543	—	—
Total plan assets	\$8,239	\$8,239	\$	—\$	—\$7,629	\$7,629	\$	—\$ —

The expected long-term rates of return on plan assets are equal to the yields to maturity of appropriate indices for government and corporate bonds and by adding a premium to the government bond return for equities. The expected rate of return on cash is the Bank of England base rate in force at the effective date.

Level 1 investments represent mutual funds for which a quoted market price is available on an active market. These investments primarily hold stocks or bonds, or a combination of stocks and bonds.

### Defined Contribution Plans

The Company has defined contribution plans in domestic and international locations under which the Company matches a portion of the employee's contributions and may make discretionary contributions to the plans. The Company's contributions were \$152 thousand and \$129 thousand for the years ended September 30, 2017 and 2016, respectively.



## 12. Lines of Credit

As of September 30, 2017 and September 30, 2016, the Company maintained a line of credit note that allows for borrowings of up to \$1.0 million. Availability under this facility is reduced by outstanding borrowings thereunder. The interest rates on outstanding borrowings is the London Inter-Bank Offer Rate (“LIBOR”) plus 2.5%, with a floor of 4%. Borrowings under the credit agreement are required to be repaid on demand by the lender in some cases, upon termination of the agreements or may be prepaid by the Company without penalty. The credit agreement is not subject to financial covenants and the Company did not borrow under the line of credit during the fiscal years ending September 30, 2017 and 2016.

As of September 30, 2017 and September 30, 2016, the Company maintained an inventory line of credit that may be used by the TS division in the U.S. to purchase inventory from approved vendors with payment terms which exceed those offered by the vendors. No interest accrues under the inventory line of credit when advances are paid within terms, late payments are subject to an interest charge of Prime plus 5%. The credit agreements contain financial covenants which require the Company to maintain the following division specific financial ratios: (1) a minimum current ratio of 1.2, (2) tangible net worth of \$2.5 million and (3) a maximum ratio of total liabilities to total net worth of less than 5.0:1. As of September 30, 2017 and September 30, 2016, Company borrowings under the inventory line of credit were \$3.1 million and \$3.2 million, respectively, which is included as a component of accounts payable and accrued expenses on the accompanying consolidated balance sheets.

## 13. Commitments and Contingencies

### Leases

The Company occupies office space under lease agreements expiring at various dates during the next ten years. The leases are classified as operating leases and provide for the payment of real estate taxes, insurance, utilities and maintenance.

The Company was obligated under non-cancelable operating leases as follows:

Fiscal year ending September 30:	(Amounts in thousands)
2018	\$ 852
2019	735
2020	609
2021	295
2022	201
	\$ 2,692

Occupancy expenses under the operating leases approximated \$1.0 million in 2017 and \$1.2 million in 2016.

### Common Stock Repurchase

From time to time the Company's Board of Directors passes resolutions to authorize the Company to purchase shares of its outstanding common stock. The Company did not repurchase any shares during the years ended September 30, 2017 and 2016. As of September 30, 2017, the Company is authorized to repurchase an additional 201 thousand shares pursuant to such resolutions.



## 14. Segment Information

The following table presents certain operating segment information.

For the Years Ended September 30,	HPP Segment  (Amounts in thousands)	TS Segment			Total	Consolidated Total
		Germany	United Kingdom	U.S.		
2017						
Sales:						
Product	\$7,608	\$8,322	\$10,727	\$58,018	\$77,067	\$ 84,675
Service	6,236	14,668	763	5,140	20,571	26,807
Total sales	13,844	22,990	11,490	63,158	97,638	111,482
Profit (loss) from operations	1,467	377	(30 )	1,958	2,305	3,772
Assets	17,782	17,055	6,878	17,213	41,146	58,928
Capital expenditures	99	151	—	108	259	358
Depreciation and amortization	224	188	9	252	449	673
2016						
Sales:						
Product	\$11,190	\$4,863	\$7,066	\$54,716	\$66,645	\$ 77,835
Service	5,152	15,130	925	4,325	20,380	25,532
Total sales	16,342	19,993	7,991	59,041	87,025	103,367
Profit (loss) from operations	1,464	676	(363 )	2,024	2,337	3,801
Assets	17,717	13,751	3,748	13,491	30,990	48,707
Capital expenditures	227	322	97	89	508	735
Depreciation and amortization	232	158	79	230	467	699

Profit (loss) from operations is sales less cost of sales, engineering and development, selling, general and administrative expenses but is not affected by either non-operating charges/income or by income taxes. Non-operating charges/income consists principally of investment income and interest expense. All intercompany transactions have been eliminated.

The following table details the Company's sales by operating segment for fiscal years September 30, 2017 and 2016. The Company's sales by geographic area based on the location of where the products were shipped or services rendered are as follows:

2017	Americas	Europe	Asia	Total	% of Total
(Amounts in thousands)					
HPP	\$10,340	\$1,437	\$2,067	\$13,844	12 %
TS	59,642	36,060	1,936	97,638	88 %
Total	\$69,982	\$37,497	\$4,003	\$111,482	100 %
% of Total	63	% 34	% 3	% 100	%
2016					
HPP	\$11,417	\$1,584	\$3,341	\$16,342	16 %
TS	59,698	26,376	951	87,025	84 %
Total	\$71,115	\$27,960	\$4,292	\$103,367	100 %
% of Total	69	% 27	% 4	% 100	%

Substantially all Americas amounts are United States.

Long-lived assets by geographic location at September 30, 2017 and 2016 were as follows:

	September 30, 2017	September 30, 2016
	(Amounts in thousands)	
North America	\$1,078	\$ 1,348
Europe	597	619
Totals	\$1,675	\$ 1,967

Deferred tax assets by geographic location at September 30, 2017 and 2016 were as follows:

	September 30, 2017	September 30, 2016
	(Amounts in thousands)	
North America	\$1,962	\$ 1,990
Europe	865	1,064
Totals	\$2,827	\$ 3,054

The following table lists customers from which the Company derived revenues in excess of 10% of total revenues for the years ended September 30, 2017 and 2016.

	For the years ended	
	September 30, 2017	September 30, 2016
	Amount % of Revenues	Amount % of Revenues
	(Amounts in millions)	
Customer A	\$22.1 20 %	\$ 19.6 19 %
Customer B	\$11.1 10 %	\$ 13.2 13 %

In addition, accounts receivable from Customer A totaled approximately \$2.4 million, or 9%, and approximately \$3.0 million, or 15%, of total consolidated accounts receivable as of September 30, 2017 and September 30, 2016, respectively. Accounts receivable from Customer B totaled approximately \$3.9 million, or 14%, and approximately \$2.5 million, or 13%, of total consolidated accounts receivable as of September 30, 2017 and September 30, 2016, respectively.

Two additional customers, C and D, accounted for accounts receivable of 10% or more but did not account for sales of 10% or more. Accounts receivable from Customer C totaled approximately \$4.5 million, or 16%, and approximately \$1.5 million, or 8%, of total consolidated accounts receivable as of September 30, 2017 and September 30, 2016, respectively. Accounts receivable from Customer D totaled approximately \$4.2 million, or 15%, and approximately \$0.7 million, or 3%, of total consolidated accounts receivable as of September 30, 2017 and September 30, 2016, respectively. We believe that the Company is not exposed to any significant credit risk with respect to the accounts receivable with these customers as of September 30, 2017. No other customers accounted for 10% or more of total consolidated accounts receivable as of September 30, 2017 or September 30, 2016.

#### 15. Fair Value Measures

The Company had no assets or liabilities measured at fair value on a recurring or non-recurring basis as of September 30, 2017 or September 30, 2016, except for pension plan assets values, which are discussed in Note 11.

## 16. Dividend

For the years ended September 30, 2017 and 2016, the Company declared and paid cash dividends as follows:

Fiscal Year	Date Declared	Record Date	Date Paid	Amount Paid Per Share
2016	12/23/2015	12/31/2015	1/11/2016	\$0.11
2016	2/16/2016	2/26/2016	3/11/2016	\$0.11
2016	5/11/2016	5/27/2016	6/10/2016	\$0.11
2016	8/18/2016	8/31/2016	9/9/2016	\$0.11
2017	1/12/2017	1/27/2017	2/8/2017	\$0.11
2017	2/23/2017	3/3/2017	3/17/2017	\$0.11
2017	5/24/2017	6/1/2017	6/15/2017	\$0.11
2017	8/14/2017	8/21/2017	9/5/2017	\$0.11

## 17. Related Party Transactions

During the normal course of business, the Company sold products to a company whose Board of Directors included two members of CSP Inc.'s Board of Directors. The total sales were \$283 thousand for the fiscal year ended 2016. The trade receivable was \$64 thousand as of September 30, 2016. CSP Inc's two board members were no longer board members of the same company at the end of fiscal year 2017.

## 18. Subsequent Events

On December 20, 2017, the Tax Cuts and Jobs Act bill was passed by Congress. Once the bill is signed into law, the change in the tax law will lower our overall tax rate and reduce our deferred taxes and will be treated as a discrete item in the quarter enacted. We will still need to assess the effect of the new law when enacted on our effective tax rate.